

Research @ Citi Markets Edition: Blue Wave or Ripple? What the Midterms May Change

Recorded: Oct. 26, 2026

Published: Oct. 27, 2026

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Transcript:

Opening Teaser: (00:00)

Research @ Citi Markets Edition.

Scott Chronert (00:03)

Hi, I'm Scott Chronert, Head of U.S. Equity Strategy at Citi Research. Welcome to Research @ Citi Markets Edition, covering various topics at work within the U.S. equity markets.

With me today is Dan Tobon, who heads up our FX strategy but also is the lead author on a recent note that Citi Research published on the midterm elections.

I've invited Dan here to talk about the midterms, and we'll cover various topics related to that.

Dan, thanks for joining.

Daniel Tobon (00:30)

Thanks for having me.

Scott Chronert (00:31)

All right. So let's just kick things off with a very high-level perspective, Dan, and how you see the midterms shaping up at this point as we close in within a couple of weeks now. And give us some perspective on what investors should be expecting around midterm outcomes.

Daniel Tobon (00:46)

So the midterms, they've actually already kicked off, if you think about it, given early voting in the U.S. And we've already seen tens of millions of votes come through. So interestingly enough, before we even get to Nov. 3, we might already have about half — if not more — of the votes in.

At this point, it seems very likely the Democrats are going to take the House, and it's less clear on the Senate, though it wouldn't surprise us if that ends up being the result as well. You know, this fits with historical norms, where presidents tend to lose a majority in the midterms, as well as what we typically see on presidents having a popularity rating around what President Donald Trump has at the moment.

So pretty much all signs point to the House flipping. The Senate? A little bit closer to call just because a lot of the Senate races can be idiosyncratic. But at the end of the day, it wouldn't surprise us as well there, given that gas prices stay at elevated levels, that we would likely see potentially a full sweep at the end of the day.

Scott Chronert (01:38)

Got it. So our initial views on the midterms, which we published — gosh, it was a month ago now — basically acknowledge what you're describing. The House is more certain to flip; the Senate a coin toss. But our presumption was that if we're going to analyze anything, it's probably that blue-sweep risk or opportunity, depending on one's perspective.

In the event that it unfolds that way, any specific dynamics that you think investors should be focused on?

Daniel Tobon (02:05)

The most obvious one is going to be around budgets, right? What is going to happen with the budget? That's really the only actual leverage that the Democrats will have, even if they complete the sweep, just because at the end of the day, they won't have a big enough majority to have a veto-proof or filibuster-proof majority.

So things like AI regulation etc., less likely to come from the federal level. Really, it's going to be about the budget.

There's a continuing resolution that keeps the government funded through Dec. 11. That needs to get revisited by the lame-duck Congress. Whether they'll just do another continuing resolution that kicks the can down the road a couple of months, or can actually push something bigger through that might include debt limit raises etc. remains to be seen.

We'd probably lean more toward a continuing resolution that brings the budget to Congress. And once that happens, there's all sorts of fun that can happen. We can get shutdowns. We can get right into the debt limit. It'll likely be a pretty ugly fight. Democrats are fighting for healthcare subsidies and avoiding future healthcare cuts.

So even with a Democratic sweep, it's not like we're going to see deficits get reduced. But the level of how much the deficits are impacted and the budgets are impacted, that's really the main thing to watch.

I think for investors, of course, there's probably going to be a lot of investigations. That's the other tool that Democrats will have. Doesn't mean that much will come from it, but you can think of any scenarios where companies that were viewed as being favorable toward the president, they might come under scrutiny.

Again, it's very difficult for them to necessarily enforce much action, but at the very least, the investigation process could be quite public.

Scott Chronert (3:33)

Of course, president retains veto power, so it does dilute some of the potential risks. Right?

Daniel Tobon (03:38)

Exactly.

Scott Chronert (03:39)

So our spin on this, and I'm curious for your perspective, is that in that blue-sweep scenario, if it were to unfold, we have to start fast-forwarding to what the 2028 presidential elections would look like.

And there we've begun to argue that one potential overhang, certainly for U.S. equities and maybe more broadly, would be that in a White House that shifts back toward the Democrats into 2028, we have to start thinking about implications of higher corporate tax rates.

Is that something that's in your line of sight, or is that too far out there to make a difference?

Daniel Tobon (04:15)

At least in our space, it's probably too far out there. I think FX is typically a little bit more tactical than the equity side can be at times anyway. But certainly, that would be a major consideration. If the Democrats do well in this midterm, does that carry any kind of momentum over into 2028?

And what will the Democratic Party look like in 2028? At that point, is it going to be more aligned with the rising DSA side of the party, or a little bit more on the traditional side? The risk, of course, is we see populists winning everywhere. And so, if we are going to see Democrats take the White House and maybe maintain both chambers in '28, and it's a shift to the left, probably starts causing some concerns on the growth side. But I think at least in our space, we wouldn't be trading that even in 2027.

Scott Chronert (04:59)

Got you. Is there anything that you're seeing out there in any of the polling that suggests a move towards center for both parties vs. this more-polarized extreme narrative that seems to have been at work in the recent years?

Daniel Tobon (05:13)

Yeah, I think that's debatable. It remains debatable at the moment. It's like a Rorschach test. You can see what you want in this, I believe.

Certainly, we've been of the perspective that it does look like there's a bit of a sentiment shift. We've seen it. Maybe we're biased because we're in New York City, and so we see it a little bit more on the East Coast, and on the West Coast. But it does feel like that could be a bit more material.

We'll see what happens in Michigan. We'll see what happens in Texas. That could be more informative as to which direction it's likely to go.

Scott Chronert (05:39)

OK, so we'll come back to other state discussions in just a second. But just to play that out, we've been of the view that fundamentals, certainly for the S&P 500, will be mostly unchanged regardless of the outcome of the midterms. And that's just a function of the timing factor that needs to go along with any potential change in legislative agenda, or what-not.

But we've also argued that you could get more siloed exposures. As an example, we've been more constructive on health care vs. financials, which is essentially a reverse of the playbook that occurred going into the '24 elections.

But as you think about that budget focus going forward, Dan, are we still looking at the back-of-the-envelope math that we've got to keep the government operating, but no material change in deficit is what we've been suggesting? Is that resonating with you as well?

Daniel Tobon (06:26)

I mean, it depends on how you define "material," and in what time horizon.

If we're getting the Affordable Care Act subsidies back on, and the Medicare-Medicaid cuts are avoided, it's going to be deficit-inducing. But regardless of what happens with that, we still have a demographic issue. Which means that every year, even with no new spending bills, the demographics just cause greater mandatory spending relative to revenue. So unless we actually get a material change in policy and probably something that requires bipartisan support, deficits are here to stay. Deficits are here to get worse.

The one thing that could maybe turn that around is if we really get this productivity shock and productivity growth, and we start running at 3%-plus real GDP growth, then maybe things could start looking a bit different.

Scott Chronert (07:11)

OK, so let me just jump on that for a second. This is something that's been a focus of ours — albeit a longer-term one — on demographics. That essentially is that the U.S.

economy in our work runs into an issue, middle of the next decade, in terms of just the demographic shift and how you continue to argue in favor of positive nominal GDP.

And that's where AI comes into this discussion. At some level, to the point you mentioned, Dan, we need this productivity driver if longer-term, we're going to continue to see a positive nominal and then real GDP response.

So as you look at the AI discussion point, I know there's certainly going to be some federal-level discussion on how to think about regulatory backdrop, but the state level is where it seems like a lot of the battleground on data-center opportunities are being played out. How do you see that unfolding?

Daniel Tobon (07:59)

Yeah, that one's trickier to say and probably very idiosyncratic to location. I think first and foremost, it's a very hot topic right now. And so it's very likely that at least in the very short term, this remains topical.

Will that momentum carry over into next year? Maybe, but maybe not. Maybe when you don't have an election to be very rhetorical over, maybe you're not bringing it up as much, because potentially there could be some benefits to a state or a municipality that is seeing these data centers. And so maybe that might ease the dynamic.

It's very hard to say at this point. You know, it'll be very state-specific and some states seem very aggressive — at least right now — in the rhetoric, in avoiding anything from happening. But certainly, if there's some education around how much water usage is really taking place, or maybe some of the financial benefits that could come from having that, maybe things end up being a little bit easier.

Certainly, at the federal level, though, given the Trump administration's focus and there won't be enough of a majority to fight back against, at least on a federal level, certainly doesn't seem like it's going to be a big constraint.

Scott Chronert (08:56)

OK. So I'm going to sum things up here and keep to our allotted time for our podcast. So generally speaking, we're still looking at most obvious odds with a House push to the blue side, with the Senate still open for debate.

You're suggesting that once we get past the elections, it's going to be Budget 101 back at work here. And then we'll have to be keeping an eye, it sounds like, in terms of how some of the state voting goes as it plays out for the AI data-center backdrop.

So it sounds like in general, we're going to learn something with midterms, but it sure looks like and sounds like a lot of the ongoing uncertainty around a lot of key issues — such as deficits, such as AI — are probably going to be with us for some time to come.

We'll wrap things up there, Dan. Thank you very much.

This podcast was recorded on Oct. 26, 2026. Thanks for joining today and be sure to be on the lookout for our next Markets podcast featuring Dirk Willer, Citi's head of Global Asset Allocation. Also be sure to watch for our other Research @ Citi podcast series, which you can also view on the same channel. Thanks, and have a great day.

Disclaimer (10:00)

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