# 2026 Midterm elections: Implications of a divided government

## Headlines

- **Democrats have won majorities in both the House and Senate following the November 3rd midterm election –** while not all races have been formally called yet, Democratic control of both chambers is now effectively assured. Democrats also flipped several Governorships, most notably in Texas.

- The result cements a **gridlocked government for the next two years.** President Trump and the Republicans remain in control of the executive branch. While Democrats have majorities in the House and Senate, **they are not projected to hold enough Senate seats to override presidential vetoes.**

- One of the most likely consequences of the gridlocked government is an **extended debt ceiling standoff that goes down to the deadline**, similar to the 2023 episode. **The stakes, however, are higher this time, given the recent rise in bond yields and term premia.** Growing U.S fiscal concerns could be exacerbated by another extended debt ceiling standoff.

- While Democrats are likely to use their congressional majorities to advocate for healthcare affordability measures and protections for the social safety net, gridlocked government and the presidential veto mean that **major legislative changes to taxes and spending remain unlikely.**

- The rapid increase in data center construction nationwide was widely cited as a top topic for voters. **State-level election wins could now allow Democrats to enact limits and oversight on new data center construction, potentially slowing the pace of AI-driven capex that has been a strong driver of recent economic growth.**

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## A gridlocked government

For the last two years, Republicans have enjoyed majorities in both chambers of the legislature alongside control of the executive branch, easing the pathway to enact legislation.

Now, Democrats swept majorities in both the House and the Senate in the midterm elections. This ends the single-party control of the legislative and executive branches. While Democrats will be able to unilaterally advance legislation through the legislative branch, they do not have the votes to overcome the presidential veto power (which requires a two-third's vote in both the House and the Senate – Democrats will fall well short of the required seats in both chambers). All legislation will thus require some amount of bipartisan negotiation between the Democrat-controlled legislature and the Republican presidency.

Democrats also fell a few seats short of a filibuster-proof majority in the Senate. While Democrats could use reconciliation to mandatory spending and debt ceiling bills while bypassing the filibuster, they would still end up contending with the presidential veto. Bipartisan negotiation in the Senate is likely to be required in addition to negotiation with the President.

Despite these constraints, Democrats are likely to use their congressional majorities to advocate for policies focused on healthcare affordability, strengthening the social safety net, and reducing the impact of spending cuts enacted in recent fiscal legislation. Priorities are likely to include reversing some reductions to Medicaid and other healthcare-related subsidies, extending support for lower-income households, and preserving elements of the broader social safety net. While Democrats may also seek to reverse selected provisions of the One Big Beautiful Bill Act, significant tax changes appear unlikely given divided government and the presidential veto.

There are a few very likely and relevant economic consequences of such gridlock and the broader outcomes of the midterm elections. Debt ceiling negotiations, future budget bills, the usage of executive order and tariff powers by the President, and the regulatory environment for AI and data center construction all could be impacted.

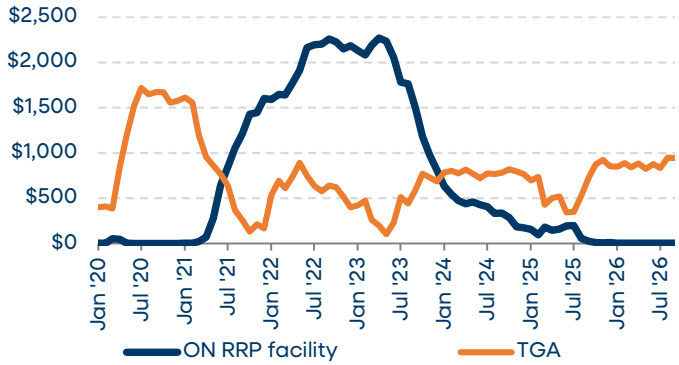
Divided government may also have implications for future Federal Reserve appointments. Democratic control of the Senate preserves a meaningful role in confirming future nominees to the Board of Governors and other senior Federal Reserve positions. This could limit the scope for rapid changes in the central bank's leadership while having little direct effect on near-term monetary policy.

## Negotiating the debt ceiling

The debt ceiling is likely to become binding sometime in the first half of 2027, and a divided government would likely make negotiations more contentious, increasing the risk of prolonged brinkmanship. Once the limit is reached, the Treasury would rely on its cash balance and extraordinary measures—temporary accounting steps that create additional borrowing capacity—to continue meeting federal obligations while negotiations to raise the debt ceiling proceed.

Once lawmakers reach an agreement, the Treasury would need to issue a large volume of securities to replenish the Treasury General Account (the federal government's checking account at the Federal Reserve). This wave of debt issuance could temporarily pull liquidity from financial markets, place upward pressure on short-term funding rates, and increase Treasury market volatility.

**Figure 3:** A Smaller Fed Cash Cushion Could Make the Next TGA Rebuild More Disruptive

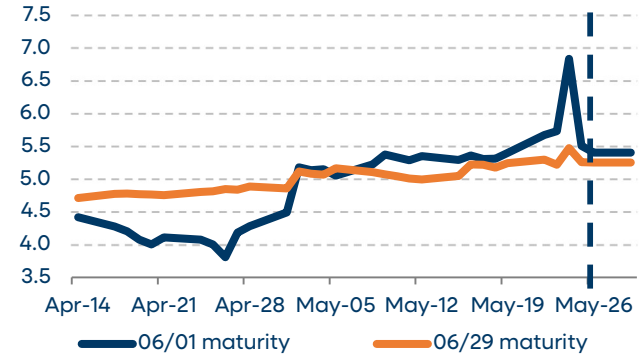



Sources: FRB NY, PNC

## The X-Date Effect

The 2023 debt ceiling episode demonstrated that investors actively repositioned away from Treasury bills maturing near the projected X-date, the date at which the Treasury will no longer be able to employ extraordinary measures to fund the government. During the 2023 debt ceiling episode, the X-date was projected at the start of June 2023. Investors rotated away from Treasury Bills expiring around that date, driving yields on the affected bills sharply higher than those of bills expiring later that month.

**Figure 4:** Front-end treasury bills during the 2023 crisis

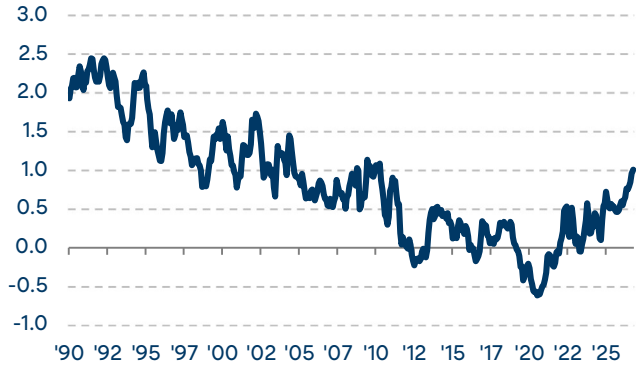



Sources: Bloomberg, PNC

## This time could be different for longer-dated treasury yields

Historically, down-to-the-wire debt ceiling episodes have pushed longer-dated U.S. Treasury yields lower as investors seek safe assets. This time, however, the response could be different. Treasury yields have risen sharply over the past year, in part due to an increase in term premia. Against this backdrop, another prolonged debt ceiling standoff could intensify concerns about the U.S. fiscal outlook and place upward pressure on longer-dated yields.

**Figure 5:** Kim-Wright U.S. 10-Year treasury premium




Sources: FRED, PNC

## Could the debt ceiling be lifted early?

The new legislature does not get seated until after New Year's Day. In the lame duck period between now and then, President Trump could ask Republicans to *raise the debt ceiling early* while they still have majorities in the legislature.

Reconciliation can be used to pass debt ceiling bills while avoiding the Senate filibuster, and thus is an option open to the lame duck Republican-held Senate. As Democrats are likely to use debt ceiling negotiations in 2027 as a cudgel to extract concessions from President Trump, there's a risk that Republicans instead resolve the debt ceiling early. This would be very atypical for Congress but is certainly possible. There are no economic downsides in our view to raising the debt ceiling

early, and most of the potential consequences are a function of any stand-off trying to raise the debt ceiling, not actually raising the ceiling itself.

## Passing a new budget

The divided government may make it difficult for Congress to pass all 12 appropriations bills needed to fund the government for the next few fiscal years. Without a discretionary budget in place for each fiscal year, the federal government experiences a shutdown. The deadline to avoid a government shutdown for FY 2027 is December 11th, 2026 (this is before the new Congress gets seated), while another bill will be required come September 30th, 2027 for FY 2028. Political gridlock brought about by a divided legislature and executive branch could result in increased usage of continuing resolutions to avoid government shutdowns.

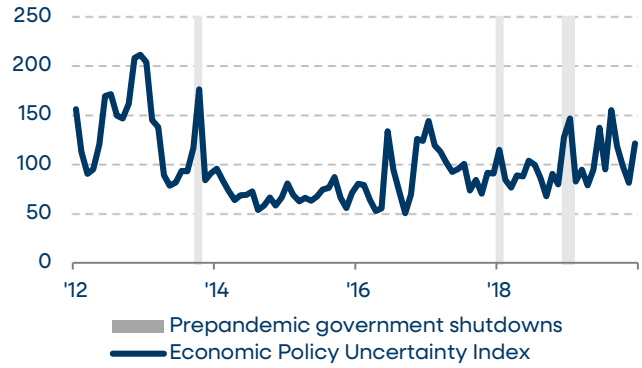
Continuing resolutions typically maintain discretionary funding at existing nominal levels, ignoring the effects of inflation. If maintained for an extended period, this could constrain inflation-adjusted federal spending and modestly reduce its contribution to economic growth.

With Democrats in control of the legislative agenda, they may seek concessions on spending priorities, tax policy, defense funding, foreign aid, and other issues during negotiations over future budget bills (to avoid a shutdown) and the debt ceiling.

Any funding measure would require President Trump's signature, giving both parties negotiating leverage into deadline dates. A more prolonged and contentious process could increase the possibility of temporary government shutdowns near budget bill deadlines.

Congress and the White House may ultimately reach an agreement before any prolonged disruption occurs, although negotiations could still produce periods of elevated policy uncertainty Such uncertainty can weigh on business and household confidence, potentially delaying investment and major purchases. Short-term Treasury markets could also experience greater volatility if investors become concerned about policymakers' ability to address fiscal deadlines in a timely manner.

**Figure 6:** Government Funding Disputes Can Heighten Policy Uncertainty




Sources: Economic Policy Uncertainty, PNC

Republicans may attempt to pass a debt ceiling raise or a full FY 2027 budget bill during the lame duck session of Congress to avoid having to negotiate with Democrats to enact such legislation in 2027. Republicans cannot use reconciliation on the discretionary budget bill, so such an effort would still require Democrat votes. Assuming they get such votes, it likely would delay some of the impact of split legislative and executive bodies of government – if Republicans make this effort, we'd expect to see headlines on it in the aftermath of the midterms.

## Executive authority and trade policy

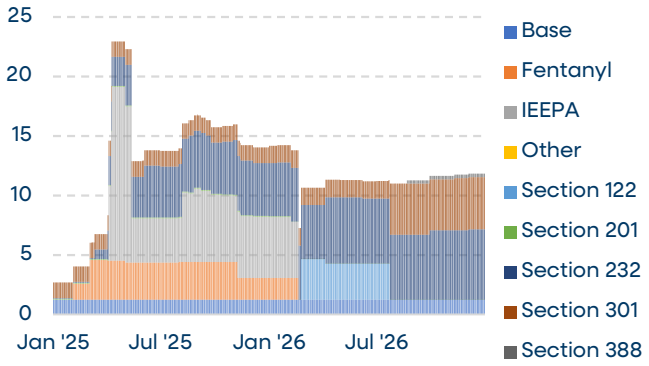
The Democratic controlled legislature will likely significantly constrain the Trump administration's legislative agenda, increasing the likelihood that existing executive authorities—including tariffs—are set to play a larger role in advancing fiscal policy objectives.

Following legal challenges to the administration's use of the International Emergency Economic Powers Act (IEEPA), the White House has

increasingly relied on more established trade authorities to advance its tariff agenda. The administration has already initiated investigations covering strategic industries such as semiconductors, pharmaceuticals, copper, critical minerals, commercial aircraft, and shipbuilding, creating a framework for future tariff actions independent of congressional approval.

President Trump could continue to use Section 232 national-security investigations to support tariffs or quotas on imports from strategic industries. The administration could also use Section 301 to impose or expand tariffs in response to foreign trade practices deemed unreasonable, discriminatory, or harmful to U.S. commerce, as it has frequently done in measures involving China.

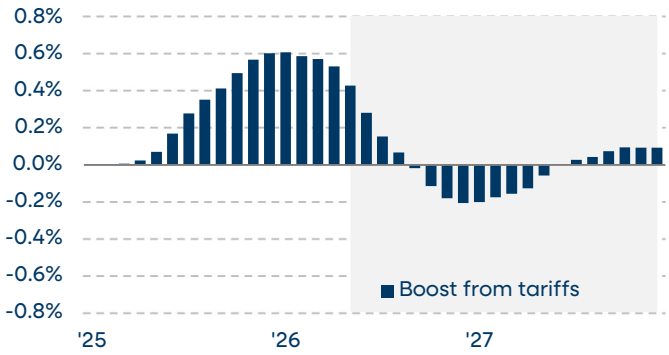
**Figure 7:** Import-weighted statutory tariff rate




Sources: Yale Budget Lab, PNC

A resumption of repeated executive tariff actions could reignite core goods inflation and pose an additional challenge for the Federal Reserve during a conflict-driven energy shock.

**Figure 8:** Tariffs have contributed to upward pressure on core PCE inflation (y/y % chg.)




Sources: BEA, PNC

Increased use of tariffs could also increase trade policy uncertainty, weigh on business confidence, and delay investment. A survey conducted by the Federal Reserve Bank of Atlanta in 2025 of nearly 1,000 business executives found that 45% reported plans to reduce capital investment over the following six months because of policy uncertainty, much of which reflected trade-policy concerns.

## The data center debate

The rapid buildout of AI-related data center infrastructure has become an increasingly visible political issue and appears to have been a meaningful campaign issue in a number of Federal and State level elections across the country.

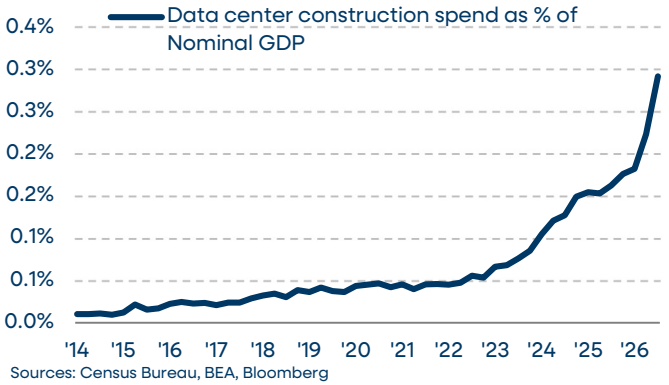
Sweeping federal regulation of artificial intelligence appears unlikely under a divided government, particularly given the Trump administration's emphasis on accelerating AI innovation and infrastructure development. However, Democratic wins in several state-level elections could increase regulatory scrutiny of data center development in some jurisdictions.

Data centers were widely cited issues in the Texas, Kansas, Ohio, Georgia, Maine, Iowa and Wisconsin governor races. While Congress' ability to materially slow the broader AI infrastructure buildout is limited, some newly elected Democratic governors and state legislatures may seek greater oversight of

data center development, particularly with respect to energy usage, water consumption, and local infrastructure demands. Potential measures could include stricter permitting requirements, additional resource-use conditions, or enhanced regulatory review. Such measures could slow project development in certain states and pose a modest downside risk to the pace of AI-related capital spending.

AI-related capital spending has become an increasingly important source of domestic demand, supporting construction, equipment purchases, and activity across the broader AI supply chain. To the extent that regulatory changes slow project development, the effects would likely be felt first through weaker construction and investment activity in affected regions. At the national level, however, the macroeconomic implications remain uncertain given the substantial pipeline of projects already underway and continued strong private-sector interest in AI infrastructure. As a result, regulatory changes may prove more consequential for the timing and location of future development than for the overall trajectory of AI-related investment. A moderation in AI-related investment could also ease some of the inflationary pressures associated with the buildout.

**Figure 9:** Data center construction expenditure has risen rapidly as a share of nominal GDP.




Sources: Census Bureau, BEA, Bloomberg

## Disclosures

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