

Foreign capitals, state capitols

Election Watch 2026

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UBS Road to the Midterm Elections

We sit down with research analysts and political experts to examine key topics in the 2026 US midterm elections.

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Foreign capitals, state capitols

In *Federalist No. 45*, James Madison argued that the federal government's powers would focus principally on "external objects," including war, peace, negotiation, and foreign commerce, while state governments would retain broad responsibilities touching the lives, livelihoods, and prosperity of their citizens. More than two centuries later, that founding-era perspective offers a useful, though not exact, lens for viewing the US midterm elections.

This edition of *Election Watch 2026* looks beyond Washington precisely because that is usually where most of the attention is focused during midterm elections. Often overlooked is the impact of US elections on other countries and the impact of state and local elections on US policy.

We first turn outward to Europe, Switzerland, Canada, emerging markets, and Asia Pacific, where investors and policymakers are assessing what the elections may mean for US trade, foreign policy, fiscal policy, and technology. The Constitution divides the federal government's authority over external affairs between the president and Congress, making the prospect of divided government especially relevant after a turbulent first two years of the Trump administration. Many countries are watching to see whether a Democratic Congress will impose stronger checks on the administration's use of executive authority.

We then turn to 36 gubernatorial elections and other state contests, where voters will choose leaders with broad authority over the "internal order, improvement, and prosperity" of their citizens. Federal spending cuts will likely force governors and state lawmakers to make difficult choices on housing, health care, energy, education, infrastructure, and data centers.

Washington remains consequential, but it does not command the entire field of view. Under either of our leading congressional scenarios, the White House will likely retain broad authority over trade, immigration, and foreign policy, leaving governments and investors abroad to assess the durability and reach of US policy. At home, governors and state lawmakers will decide how to absorb federal funding cuts, allocate constrained resources, and advance policies where Congress has acted slowly or not at all. The consequences of the midterms will therefore extend from foreign capitals to state capitols.



Ulrike Hoffmann-Burchardi
Chief Investment Officer Americas and Global Head of Equities



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Balance of power

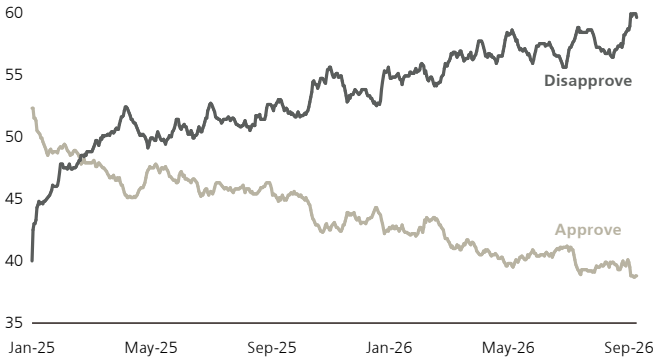
We expect the November midterm elections to shift the federal government from unified to divided control. Midterm elections have historically served as a referendum on the sitting president, and President Trump's net approval rating of –21 percentage points—in part reflecting high gas prices, surging mortgage rates, an unpopular Iran war, and broader affordability concerns—is producing the usual drag on his party's congressional candidates (see Fig. 1). Republicans are poised to retain a large number of House seats in strongly Republican districts, but polling points to enough seats moving toward Democrats to make a change in control increasingly likely (see Fig. 2). Given the narrow Republican majority in the 119th Congress, Democrats need to gain only three seats to reach the 218 required for control—an achievable outcome despite aggressive mid-decade redistricting by both parties. What's less certain is the size of the Democrats' advantage and the split between moderate and progressive members.

Democrats need a net gain of four seats to obtain a 51-seat Senate majority, as Vice President Vance will remain the tie-breaker in a 50-50 chamber. We expect Democrats to protect all of the seats they currently hold, including the two hotly contested open seats in Michigan and New Hampshire. North Carolina looks likely to provide one Republican-held pickup. Democrats will then need to win three of the competitive Republican-held seats in Alaska, Ohio, Maine, Iowa, Texas, and Kansas to reach the majority. We will closely watch the influx of advertising dollars in the most fiercely contested races during the final weeks to see if it influences voter preferences and turnout. Our assessment gives Democrats a narrow path to taking back the Senate, although close races and Alaska's ranked-choice voting system may mean the outcome of the battle for Senate control remains uncertain for several weeks after Election Day (see Fig. 3 on the next page).

Figure 1

President's approval rating fell to new low as Iran war drags on and energy prices remain high

RealClearPolitics poll average job approval and disapproval ratings, in %

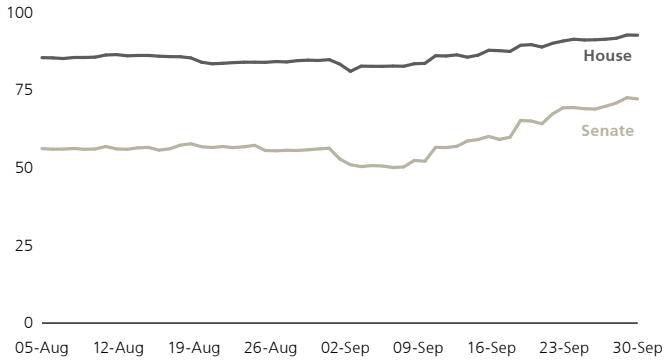


Source: RealClearPolitics, Bloomberg, UBS, as of 30 September 2026

Figure 2

Rising odds of Democratic control of Senate and House

Democrat win probability, in %



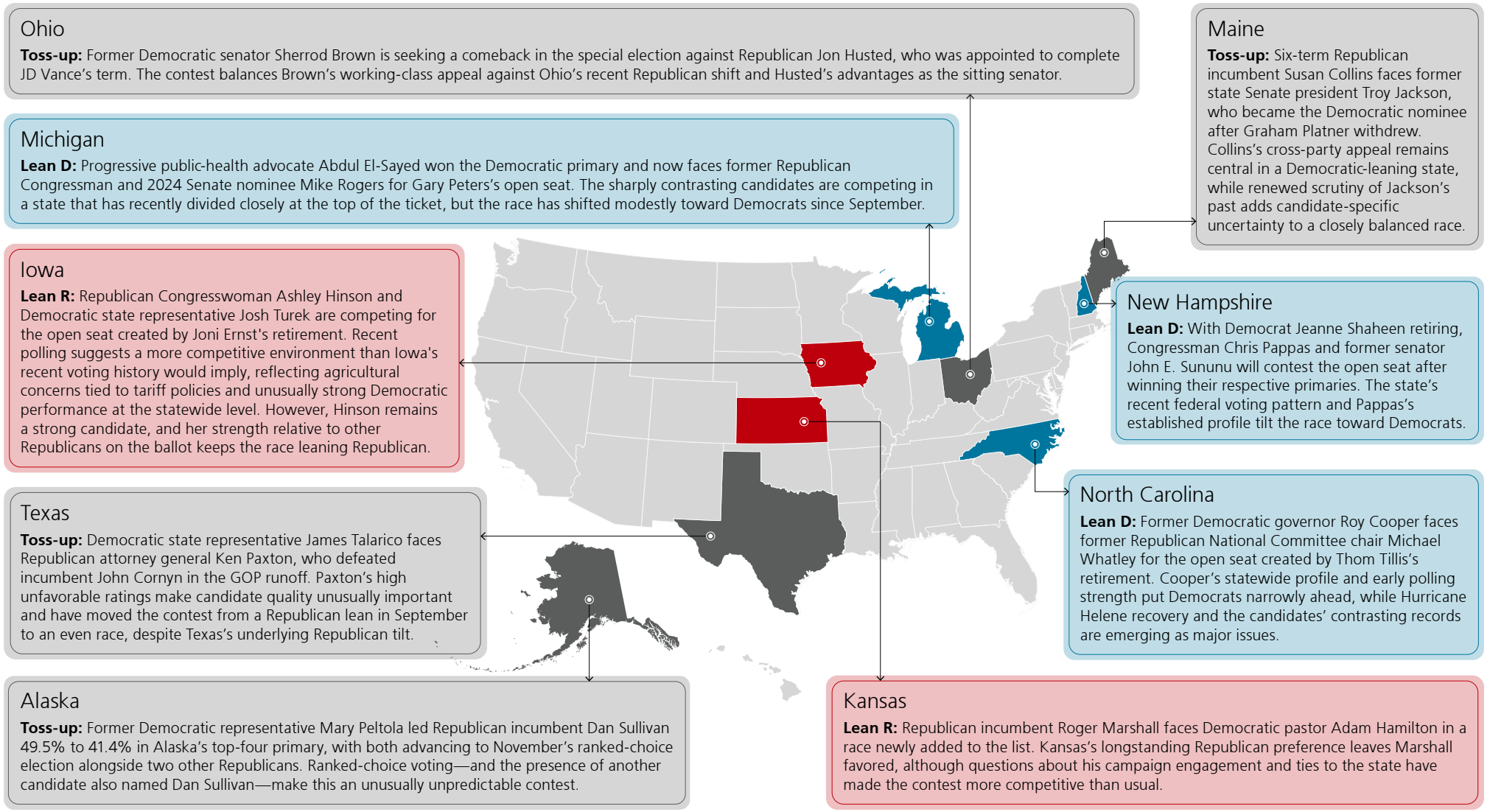
Source: Silver Bulletin FLIPR model, UBS, as of 30 September 2026



A Democratic majority in the Senate would constrain legislation without the consent of the minority except for judicial appointments, presidential nominations, and budget reconciliation.

Figure 3

Overview of close Senate races that could determine the outcome



Source: UBS, as of 2 October 2026

Scenario analysis

We assign a 50% probability to a Democratic sweep, making it our base case, closely followed by a divided Congress at 40%, and a status-quo Republican sweep at 10%. A Democratic sweep will likely produce narrow majorities, limiting the party's ability to advance legislation without Republican support or to overcome President Trump's veto.

The administration will likely continue using executive authority on trade, immigration, and foreign policy under any outcome. Courts may block the administration's interpretation of certain statutes to justify tariffs, but that is unlikely to stop the president from pursuing various economic and policy goals through other means. Democrats will likely use committee control, investigations, subpoenas, appropriations, and messaging legislation to challenge the administration, especially to intensify oversight of AI, including the labor-market effects, safety practices, and data-center infrastructure costs. These actions will likely increase political and legal pressure on the administration, even if narrow majorities and the president's veto prevent legislation from taking effect.

Divided government will very likely raise the risk of shutdowns and debt-limit brinkmanship, although lawmakers may still reach bipartisan agreements on defense spending, social programs, and housing. A Republican sweep will likely preserve the administration's legislative footing, but narrow margins, wide deficits, and the Senate's 60-vote threshold will limit the scope for major new initiatives.

Under a Democratic sweep, the composition of the new majority will likely provide an early glimpse of the party's direction heading into the 2028 presidential election. Victories by moderates in competitive states and districts will likely support an agenda focused on affordability, health care, and oversight. Greater progressive representation could send a signal that the party's shifting base supports raising taxes on upper-income individuals, strengthening social programs, and tighter constraints on corporations and AI companies. That said, narrow margins will likely give both wings leverage and make it difficult to unite around a common legislative agenda.

	Scenario	**Status quo** Republicans retain narrow control of both houses of Congress	**Divided Congress** Republicans retain control of the Senate but lose the House	**Democratic sweep** Democrats assume control of both the Senate and the House
Summary	**Election outlook**	The likelihood that Republicans retain their narrow House majority is low, given the usual midterm penalty for the president's party and the president's low job approval rating. Redistricting will benefit Republicans but is unlikely to fully offset the party's low favorability.	Democrats face a tougher uphill climb in the Senate where they would need a net gain of four seats to obtain a 51-seat majority. Recall that VP Vance remains the tie-breaker in a 50-50 Senate. Battleground states held by Republicans include Alaska, Iowa, Kansas, Maine, Ohio, North Carolina, and Texas. Battleground states held by Democrats include Michigan and New Hampshire.	The potential for a Democratic sweep has increased since the start of the Iran war and as the president's job approval falls further. In the Senate, Democrats are likely to retain all of their existing seats and flip North Carolina. Additional gains would require current Democratic polling advantages in toss-up races to sustain a massive ad blitz in the final weeks of the campaign. A Democratic majority in the Senate would constrain legislation without the consent of the minority except for judicial appointments, presidential nominations, and budget reconciliation.
	UBS probability (%)	10	40	50

Note: We do not include a fourth scenario of Democrats reclaiming the Senate and Republicans retaining control of the House given the low probability of such an outcome.

Continued on page 6 ›

	Scenario	Status quo Republicans retain narrow control of both houses of Congress	Divided Congress Republicans retain control of the Senate but lose the House	Democratic sweep Democrats assume control of both the Senate and the House
Policy implications	**Fiscal**	Republicans likely attempt to use reconciliation to achieve targeted spending goals and tax cuts, but narrow majorities and wide budget deficits curtail ambitions. Fiscal drag from cuts to Medicaid and food assistance programs would take effect after the midterms as scheduled. Small growth in annual budget spending continues.	Partisan differences complicate budget appropriations and effectively remove the possibility of using reconciliation to achieve fiscal goals. There is higher risk of government shutdowns and debt limit brinkmanship, but some potential for bipartisan agreement to postpone planned spending cuts to social programs in exchange for higher defense spending. Potential for 5% increases in the annual budget.	Democrats use reconciliation in an attempt to postpone or reverse Medicaid and food assistance cuts enacted to fund 2025 tax cut package. President Trump would likely veto such a package, but it could serve as a starting point for negotiations. Republicans agree to compromise on increased defense spending, leading to wider deficits and less fiscal drag. Democratic push for higher taxes likely faces insurmountable obstacles. Potential for 5% increases in the annual budget.
	Transportation and energy	Continued Republican control after the midterms could lead to Democrats accepting the current permitting reform package and passage during the lame duck session before the next Congress is sworn in. If permitting legislation is unable to pass in the lame duck period, Republicans are likely to propose similar legislation next year knowing that Democrats will have lost their negotiating leverage. A continued push away from renewable energy sources, such as solar and wind, is likely from the administration though a bipartisan bill could minimize the negative impacts to those industries. Renewable energy tax credits that survived the One Big Beautiful Bill Act will be tough to repeal, and fees and taxes on EVs are unlikely, though they will continue to be negotiating points. Fiscal energy and transportation policies would be possible for Republicans to accomplish in a partisan fashion via reconciliation; however, larger policy decisions will need to be bipartisan in order to clear the 60 vote threshold in the Senate.	A bipartisan permitting package becomes trickier if it does not pass in the lame duck session. While still possible, the changing of committee chairs means the new chairs will want to have their input, and are unlikely to accept the deal as written. Additionally, the longer the package takes, the more the focus will turn toward the 2028 presidential election. Both parties will be reluctant to cut large deals close to the election, and the candidates vying for their parties' nomination will have their own goals and policy platforms. A divided Congress would likely preserve more environmental safeguards, and a point of bipartisanship could be around making data-center developers bear grid and infrastructure costs. Nuclear energy is likely to retain bipartisan support.	Democrats pass legislation focused on restoring tax credits for energy efficiency and renewable energy, which will likely be vetoed by President Trump. The potential for a bipartisan compromise still exists after partisan attempts fail. Democrats may also hold oversight hearings on energy companies in an attempt to discern the reason for the rising costs of energy and to persuade voters that it is largely due to the Trump administration's actions.

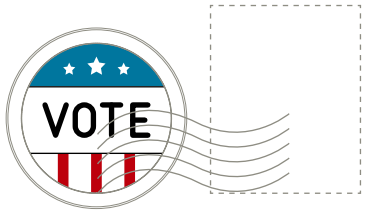
Note: We do not include a fourth scenario of Democrats reclaiming the Senate and Republicans retaining control of the House given the low probability of such an outcome.

Continued on page 7 ›

	Scenario	Status quo Republicans retain narrow control of both houses of Congress	Divided Congress Republicans retain control of the Senate but lose the House	Democratic sweep Democrats assume control of both the Senate and the House
Policy implications	**Trade**	Unlikely to see Republicans mount a challenge to the president's trade agenda, consistent with the first two years.	Substantive Democratic efforts to challenge the president's trade authority are not likely to reach the Senate floor for a vote. House Democrats are likely to increase oversight on the administration's use of tariffs, including more frequent hearings with US Trade Representative Jamieson Greer.	Without a veto-proof majority, Democratic challenges to the president's trade agenda are unlikely to become law. If US Trade Representative Greer were to leave his position, his replacement would require a confirmation vote in the Senate, which becomes much more complicated in a Democratic Senate.
	Debt limit	Fewer fireworks over raising the debt ceiling under unified Republican control of government, even if some members demand deeper spending cuts under reconciliation as part of any agreement.	Greatest potential for conflict over lifting the debt limit likely brings deadline down to the wire as in earlier episodes, rekindling concerns over technical default risk.	Debt limit deadline forces agreement between White House and Congress on a package of increased defense spending and postponed cuts to social programs enacted in the 2025 tax cut legislation. Democrats will likely float the idea of getting rid of the debt limit entirely. This is likely still a low probability occurrence; however, President Trump has previously called for the removal as well.
	Artificial intelligence (AI)	The priorities in President Trump's National AI Legislative Framework continue to be brought up in Congress; however, the need for 60 votes in the Senate means success is unlikely. Federal preemption of state AI laws will still be a policy priority for Republicans.	House Democrats would exercise oversight of AI companies. Legislation on data-center permitting and electricity costs has moved beyond a conceptual stage: the House Energy and Commerce Committee advanced a package in August. A divided Congress could therefore pursue a narrower bipartisan deal that speeds permitting while assigning more grid-upgrade costs to data-center developers, although final enactment remains uncertain.	Without a veto-proof majority, Democratic priorities are unlikely to advance. However, there will be interest in passing messaging legislation designed to protect American workers and hold AI companies accountable for the actions of their platforms. If polling continues to find Americans' opinion of AI souring, this will likely become a potent issue in the Democratic presidential primaries with candidates who are sitting senators introducing anti-AI legislation.
	Housing	Republicans would oversee implementation of the bipartisan 21st Century ROAD to Housing Act. The agenda would likely emphasize supply expansion, streamlined permitting, manufactured housing, financing reforms, and a possible increase in the capital-gains exclusion for sales of primary residences.	Republicans would oversee implementation of the bipartisan 21st Century ROAD to Housing Act, but a divided Congress would make the path bumpier. The agenda would likely emphasize supply expansion, some permitting reform, manufactured housing, and financing reforms.	The Trump administration would continue to oversee implementation of the bipartisan 21st Century ROAD to Housing Act; however, Democrats will have the ability to pursue additional affordability measures. These could potentially include restrictions on large institutional landlords and stronger tenant protections. Measures beyond the enacted supply-and-finance package would still face President Trump's veto unless negotiated as a bipartisan compromise.

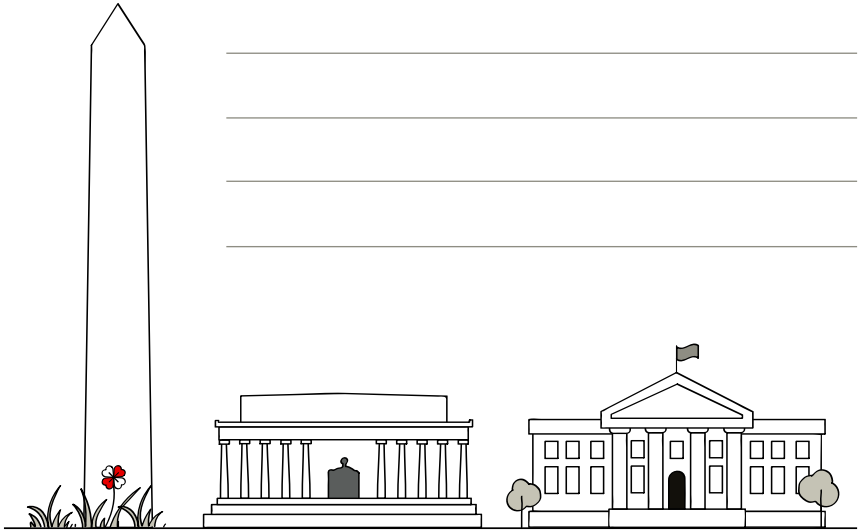
Note: We do not include a fourth scenario of Democrats reclaiming the Senate and Republicans retaining control of the House given the low probability of such an outcome.
Source: UBS, as of 3 October 2026

Postcards from abroad



The 2024 US general election reshaped not only US policy but also the choices facing governments around the world. Since then, Washington has imposed tariffs, entered a war with Iran, and threatened territorial annexation or economic damage unless allies increase defense spending. Meanwhile, a Republican-controlled Congress has only rarely voted to constrain the executive branch, leaving it to the courts to determine if the president has overstepped his authority. It was the Supreme Court, not Congress, that invalidated the tariffs imposed under the International Emergency Economic Powers Act.

We expect the midterms to produce divided government, but not the veto-proof majorities needed to enact significant new legislation or redirect foreign policy, leaving the White House with broad scope to stay its course. The consequences, however, will vary by region. Asia-Pacific faces continued pressure from tariffs, export controls, AI policy, and defense demands; Europe faces a tougher US stance on China's overcapacity, higher military spending, and US-driven financing costs; Switzerland is affected by trade and currency channels; emerging markets through trade, immigration, remittances, and global financial conditions; and Canada through the US-Mexico-Canada (USMCA) review and recurring trade uncertainty. In this report, our correspondents offer a view of the US midterms from their vantage points, where the election matters less for how it influences US domestic politics than for how it may shape the next phase of American power overseas.



Asia-Pacific (APAC)

Regardless of the US midterm election outcome, we believe the White House will retain substantial authority over tariffs, export controls, and foreign policy, limiting the scope for a major US-APAC policy reset.

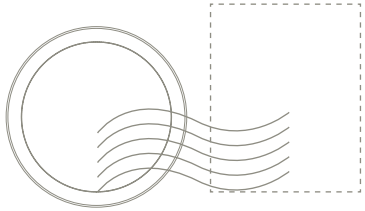
Bipartisan concern about China's geopolitical and technological rise is likely to persist, regardless of outcomes, although pressure to address affordability could test tolerance for tariffs on everyday goods. The September Trump-Xi summit at the White House has opened the door to selective tariff relief, and the November APEC leaders summit could help preserve stability into year-end. US military allies in APAC, meanwhile, face pressure to raise defense spending as a share of GDP, adding to fiscal pressure but supporting select domestic defense companies.

US tech and fiscal policy are also key. Domestic opposition to data centers could potentially slow but not derail the AI infrastructure buildout. Any policy change around US advanced tech controls or regulation for frontier model safety could also have an impact. A potential post-midterm fiscal compromise that sustains social and defense spending in exchange for lifting the debt limit could keep the Federal Reserve hawkish for longer, weighing on Asian currencies. A return to shutdown or debt-limit brinkmanship would add volatility. Still, this should not be overstated. The direction of travel for yields, the dollar, and regional APAC assets is far more complicated than a simple congressional seat count.

Though APAC volatility could rise into the vote, we do not see this as a lasting risk event for regional risk assets or a reason to change regional positioning. Chinese equities have shown little historical sensitivity. Across the past four midterm cycles, onshore and offshore markets gained more than 4% on average in the following month, and even more over three months (see Fig. 4). Regional AI investment, earnings, inflation, and energy prices should remain more important drivers.

In our view, US tech policy is the clearest lever to watch. Resistance to US data center expansion could delay compute deployment and orders for Asian semiconductor, server, networking, cooling, memory, and power-equipment providers. We see this more as a timing and revenue risk than something that ends the investment cycle. A sharper US AI slowdown driven by safety concerns or regulation could see the US-China compute and capability gap narrow at the margins, benefiting Chinese platforms and their supply chain.

Chinese leverage over rare earth access may dissuade tighter US technology curbs. If controls are nonetheless tightened, they could hurt the China AI component makers but potentially benefit Taiwanese foundries, Korean memory leaders, and other Asia-based AI suppliers outside mainland China. Stronger US rules on model verification, auditing, certification, and incident reporting could favor well-resourced US labs over Chinese open-weight competitors, influencing who captures global AI revenues.



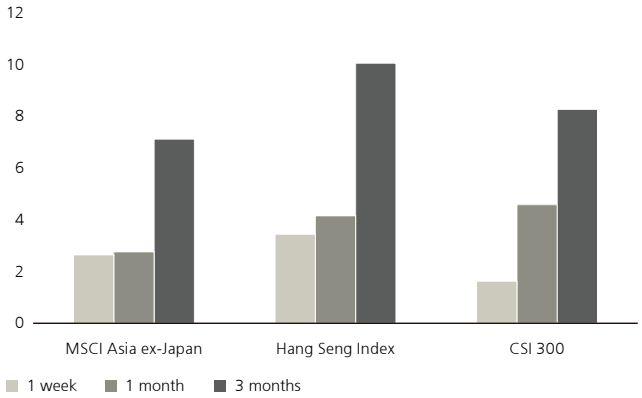
Jon Gordon

Strategist

Figure 4

Impact of the US midterm elections on Asian equities has historically been limited

Recent historical performance of Asia and China equities after US midterm elections since 2010, in %



Source: Bloomberg, UBS, as of September 2026

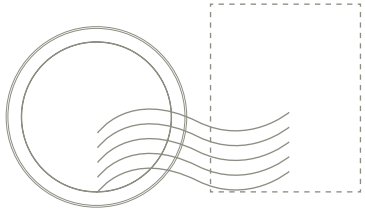
Europe

For Europe, the US midterms matter less for how they might trigger a major policy reset and more because they will influence how US policy is implemented abroad. Even in our base case of divided government with slim majorities, the White House would retain significant influence over trade, regulation, and foreign policy. The most likely impact is higher market volatility rather than a fundamental change in the economic outlook.

We focus on three areas: China, defense, and fiscal policy. While the EU-US trade agreement reduces the risk of a broad tariff dispute, Washington may continue to pressure Europe to take a tougher stance toward China to reverse its own growing bilateral trade deficit (see Fig. 5). A tougher US approach to Europe's posture toward China could create challenges for European sectors with significant exposure, either from supply chains or through falling exports which could include autos, industrials, chemicals, luxury goods, and health care. At the same time, it could accelerate investment in domestic production, strategic industries, and supply-chain resilience. Turning to defense, bipartisan support for greater European burden-sharing is also likely to reinforce higher spending and broader efforts to strengthen resilience in areas such as energy and industrial supply chains. Higher defense spending in Europe is likely to be increasingly directed toward domestic procurement, which should benefit companies and related industrial, infrastructure, software, and technology firms.

The elections are also important because US fiscal policy has global consequences. Persistent deficits and higher borrowing needs can influence US yields, which in turn affect European financing conditions, investment, and growth. This comes at a time when many governments in Europe are already feeling the burden of higher borrowing costs on their public finances. A further increase in Treasury yields could increase borrowing costs across Europe, particularly for more indebted countries.

For investors, the potential challenges around trade, defense, and fiscal policy could result in higher volatility for European assets. In our view, this reinforces the case for diversified exposure to Europe focused on quality assets and long-term themes such as rearmament, infrastructure, industrial resilience, and those companies at the forefront of technological leadership.



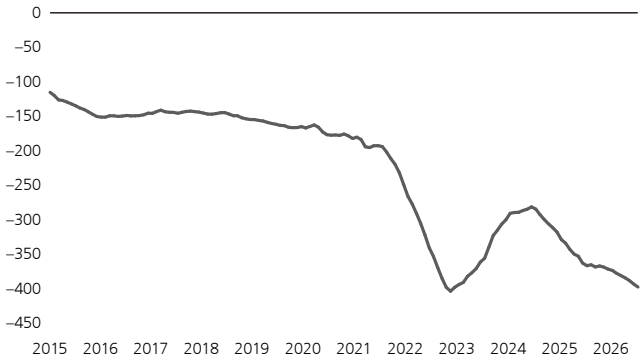
Dean Turner

CIO Eurozone and UK Economist

Figure 5

Washington's trade focus may shift to Europe's large and growing deficit with China

EU27 goods trade balance with China ex-Hong Kong, 12-month moving average, in EUR bn



Source: Haver Analytics, UBS, as of September 2026

Switzerland

Switzerland's relationship with the US is currently centered on trade, including tariffs, potential exemptions, and negotiations toward a bilateral trade agreement. We do not expect the outcome of the US midterm elections to materially alter the prospects for an agreement in the near term.

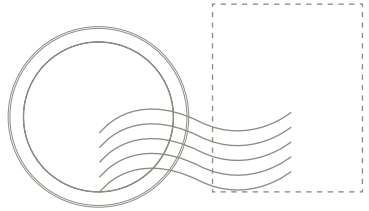
In a scenario where Washington increases pressure on its allies—particularly the EU, but also Switzerland—to take a tougher stance toward China through closer policy coordination or economic measures, Switzerland, as a small, open economy, would need to balance its economic ties with both countries carefully. Irrespective of this outcome, Swiss trade policy is to focus on diversifying the country's economic relationships through additional free trade agreements with key trading partners.

US fiscal policy could also have important implications for Switzerland through the exchange-rate channel. Even under a divided government, persistently large US deficits and a rising US debt load relative to GDP could exert upward pressure on both US Treasury yields and European government bond yields (see Fig. 6). As in the recent past, the Swiss franc could come under renewed appreciation pressure, supported by Switzerland's strong fiscal position and the currency's traditional safe-haven status.

If the Swiss franc were to appreciate significantly, the Swiss National Bank (SNB) would likely keep policy rates close to zero to offset the associated tightening in financial conditions. This, in turn, would keep Swiss franc bond yields at depressed levels. Although bonds would continue to provide portfolio stability, low—or even negative—real yields would limit their income-generating potential.

Swiss equities may appear relatively defensive in an environment of Swiss franc appreciation, but two caveats are worth highlighting. First, companies in the Swiss Market Index (SMI) generate the vast majority of their revenues abroad, so a stronger franc would weigh on reported earnings. Second, the Swiss equity market is relatively narrow and heavily concentrated in the pharmaceutical sector, leaving the benchmark exposed to meaningful concentration risk, as well as changes in the US regulatory environment for the sector.

While a lack of US fiscal discipline could increase the risk of Swiss franc appreciation, higher levels of government spending worldwide may also create opportunities for Swiss investors, even after accounting for currency strength. Targeted exposure to infrastructure and defense could provide a way to benefit from rising public investment, with select companies and assets positioned to outperform across both public and private markets. Continued investment in AI should support productivity and global economic growth, while benefiting equities across the AI value chain through stronger demand and sustained capital spending. International diversification remains key for investors with home markets that offer little direct AI exposure and that do not benefit from worldwide government spending, such as Switzerland.



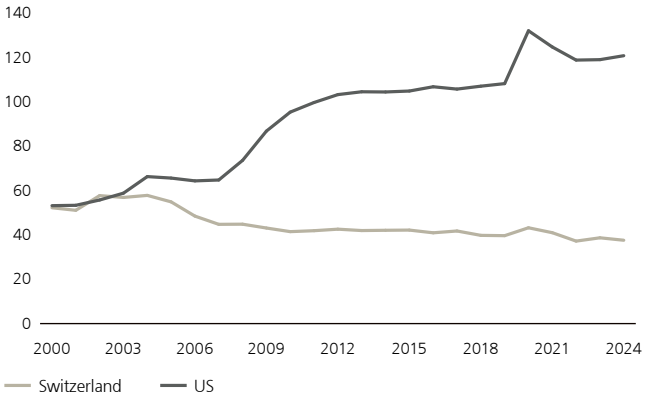
Alessandro Bee

Switzerland Economist

Figure 6

Switzerland's healthy fiscal position contrasts with rising debt in the US

General government debt as a share of GDP, in %



Source: IMF Global Debt Database, UBS, as of September 2026

Emerging Markets

The US midterm elections matter for emerging markets primarily to the extent that political shifts in Washington influence the US growth outlook, financial conditions, or the overall foreign policy approach. The executive branch will likely retain the status quo on trade and immigration, and divided government likely limits the scope for significant new legislation. Therefore, we believe the relevance of the midterm elections for emerging market assets is limited.

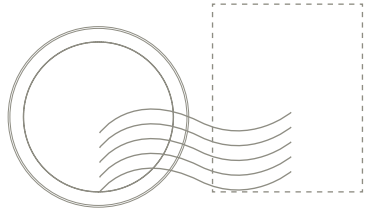
That said, countries such as Mexico, one of the United States' largest trading partners, will be closely monitoring the outcome to assess whether a more assertive Congress could constrain the White House's flexibility on trade policy (see Fig. 7). While Democratic control of either or both chambers could modestly strengthen congressional oversight, including through hearings on the use of tariffs, we do not believe it would necessarily provide sufficient support to materially restrict the administration's trade authority.

Several emerging markets, including Mexico, will also be paying close attention to any potential openings for progress on immigration and labor market reforms in the new Congress, given the potential implication for remittances and employment in both Mexico and the US.

We rate both emerging market equities and emerging market bonds as Attractive within our global portfolios. In our view, these asset classes are well positioned to withstand any political or policy changes that may result from the US midterm elections.

Emerging market equities continue to benefit from a powerful combination of resilient earnings growth, attractive valuations, and the ongoing AI-driven investment cycle supporting emerging market tech leaders like Korea and Taiwan, as well as commodities exposure in countries like Brazil. We expect earnings across the emerging market equity universe to grow by more than 60% in 2026, followed by nearly 20% growth in 2027. At the same time, emerging market equities currently trade at roughly 10x forward earnings, well below their 10-year average of 12.4x, and at a 45% discount to developed markets. Historically, that discount has averaged closer to 30%.

Emerging market bonds have also demonstrated remarkable resilience this year. Despite sharp increases in US Treasury yields, the asset class has delivered positive returns, as tighter credit spreads and elevated carry have more than offset the rise in risk-free rates. This resilience reflects stronger underlying fundamentals. Emerging market sovereigns rely far less on foreign-currency borrowing than in the past, while average government debt maturities have lengthened, reducing refinancing risks. We believe that elevated yields, combined with supportive fundamentals, continue to underpin a constructive outlook for the asset class.



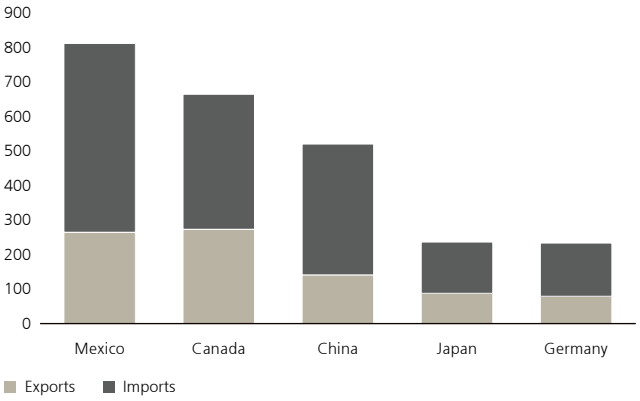
Alejo Czerwonko

Chief Investment Officer Emerging Markets

Figure 7

Mexico and China will be tracking the US midterms closely

Top five trading partners by total trade, in USD bn



Source: Bloomberg, UBS, as of September 2026

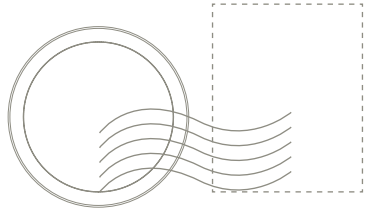
Canada

For Canada, the elections will help shape the political backdrop to the review of the USMCA and broader US-Canada relations. Recent trade disputes have led to tariffs and retaliatory measures, creating uncertainty around an agreement central to North American supply chains, investment, and manufacturing. For the smaller and more dependent economy, the negative economic implications of undermining the deep economic ties that have bound the two economies for decades are more stark.

The key question is whether the next Congress or the courts intervene to challenge elements of the president's tariff agenda, even as the US might also attempt to include tighter rules of origin and higher US content requirements in its trade agreements. While we view a complete breakdown of USMCA as unlikely, the balance of power in Congress and its relationship with the administration could influence the pace and scope of negotiations. Canada is seeking to diversify its trade relationships, but deep economic ties with the US leave Canadian businesses and investors particularly exposed to shifts in US trade policy.

The Canadian dollar's (CAD) reaction is likely to depend more on the outlook for trade certainty than on immediate policy changes. An outcome that reinforces USMCA continuity could support the CAD by easing trade-related uncertainty. Conversely, prolonged negotiations and recurring trade tensions could weaken the currency. We would expect only moderate downside, however, as we believe much of the deterioration in trade relations is already priced in.

Interest-rate differentials have recently been the main driver of USDCAD, and economic fundamentals are likely to remain dominant (see Fig. 8). Fed tightening expectations are weighing on the Canadian dollar, partly offsetting support from Canada's nascent recovery and public investment initiatives. While US-Canada trade relations remain important for the currency's medium-term outlook, we expect the midterms to have a limited impact unless they trigger a meaningful shift in the US administration's trade policy.



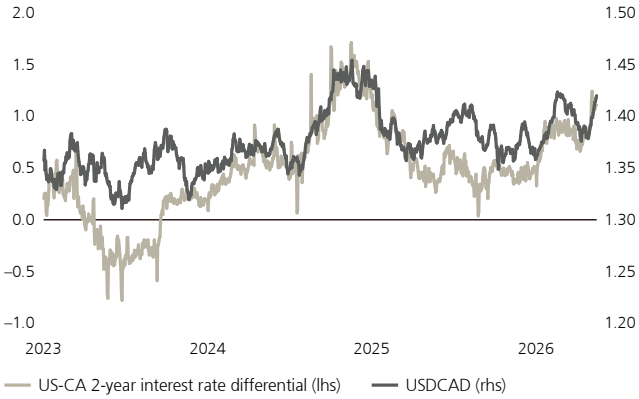
Clémence Dumoncel

Analyst

Figure 8

Interest rate differentials a primary driver of USDCAD in recent years

Daily USDCAD exchange rate and respective 2-year interest rate differential, in percentage points



Source: IMF Global Debt Database, UBS, as of September 2026

A focus on state capitols

While the spotlight during US midterm elections often shines on Congress and how the outcome could influence the nation's policy direction, there are many consequential state and local government elections that will influence how policy evolves to address voter concerns. Importantly, 36 states, three US territories, and the District of Columbia are all holding elections in 2026 to choose their next leader and determine the control of the state executive. Of these, roughly 60% are considered open-seat contests because of either retirements or term limits, limiting the incumbency advantage in the majority of races. That said, most of these open-seat races are in states with entrenched partisan leanings, reducing the number of contests that are truly competitive to just a handful (see Fig. 9). According to the Cook Political Report with Amy Walter, there are five tossup races: Alaska, Georgia, Nevada, Ohio, and Wisconsin.

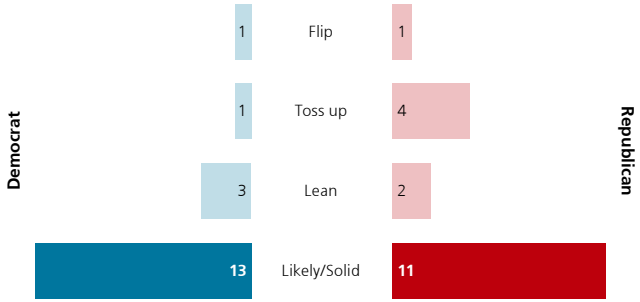
Looking at the balance of power across the entire US, Republicans hold the governor's office in 26 states, while Democrats control the remaining 24. Democrats could pick up between two and four governorships in the 2026 midterm elections if they maintain their voter turnout advantage from the primaries and a high single-digit lead on the generic ballot. This would shift the balance slightly in the Democrats' favor.

If Democrats were to pick up more statehouses in November, they might also come away from election night with more state trifectas, meaning control of the governor's mansion along with the state House and Senate. Republicans have held the advantage in statehouse trifectas for the past 15 years, but that advantage began eroding after the start of President Trump's first term (see Fig. 10). Democrats' clearest opportunities to establish new trifectas are in Nevada and Minnesota, followed by Michigan, Wisconsin, and Arizona. Republican trifectas are most vulnerable in Iowa and Georgia, with Ohio and New Hampshire also at risk. Any additional gains would give Democrats more leverage in the ongoing mid-decade redistricting battle ahead of the 2028 election, while bringing state policy more closely in line with the party's core priorities.

Figure 9

More toss-up Republican governor races than Democratic

2026 governor race ratings

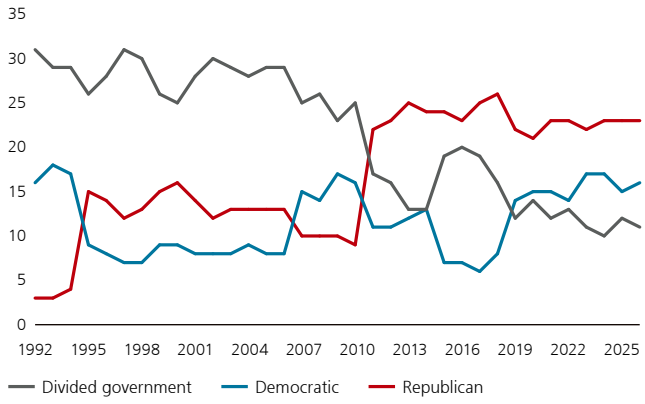


Source: The Cook Political Report with Amy Walter, UBS, as of 2 October 2026

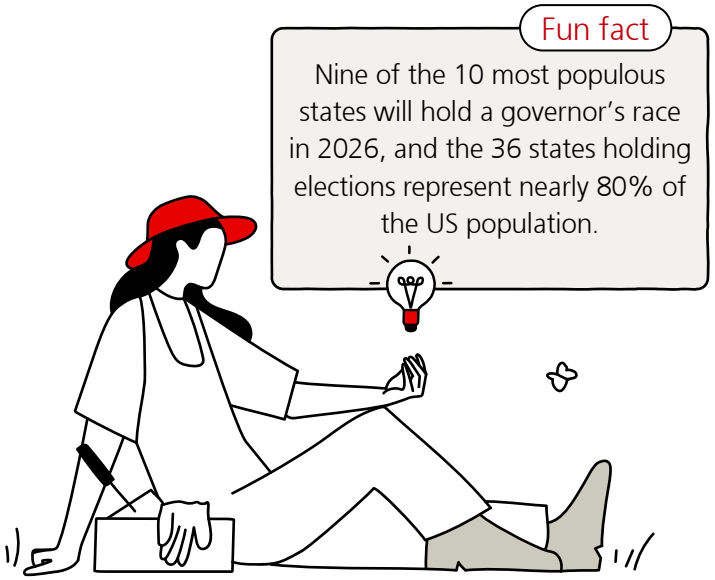
Figure 10

Democrats aim to narrow the Republican lead in state trifectas

State government trifectas



Source: Ballotpedia, UBS, as of 2 October 2026



Although gubernatorial elections and statewide referendums have no effect on the control of Congress, they can influence federal priorities, shape the implementation of national programs, and alter the fiscal relationship between the federal government and the states. A useful starting point for assessing these effects is the current division of powers and responsibilities (see Fig. 11). While states retain broad authority over matters such as education, public safety, and local government, the federal government exercises powers granted by the Constitution. Many responsibilities overlap, making the balance of policymaking authority and funding central to both election outcomes and state credit quality.

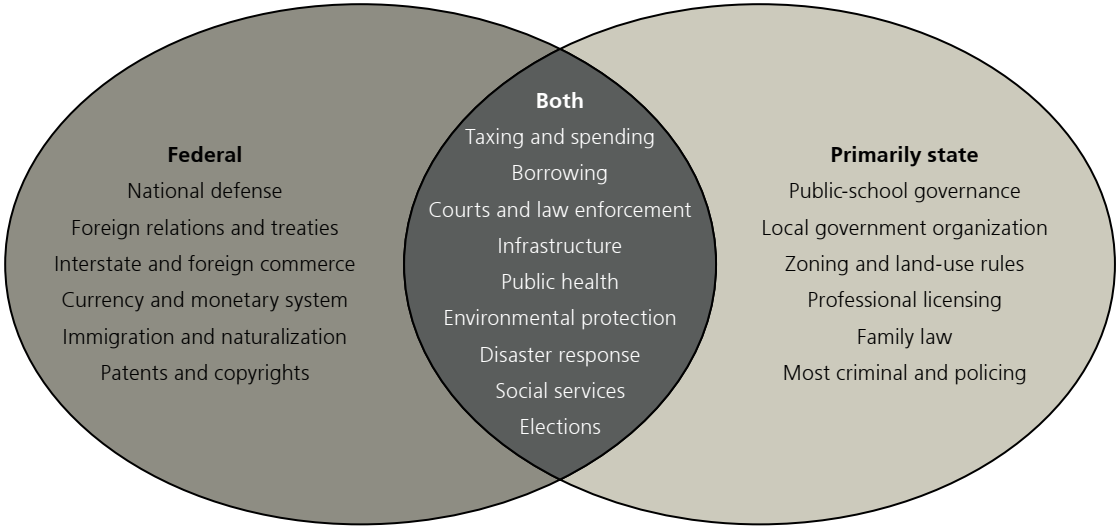
Evolving federal-state funding and responsibilities

The municipal market is closely tied to federal policy because state and local governments share responsibility for delivering essential public services, and they also rely heavily on federal funding to do so. Federal fiscal decisions also shape state economies by influencing employment, consumption, development, and the income and sales tax revenues that states collect. The push and pull between power and funding the nation's critical capital, infrastructure, social, and health care needs is not new, but rather a cyclical story which has evolved over time (see Fig. 12 on the next page). As those needs have expanded, so too have funding demands. While tax levels and the allocation of responsibilities across different levels of government have fluctuated over time, the range of activities financed through taxation is far more extensive today than in the past.

Figure 11

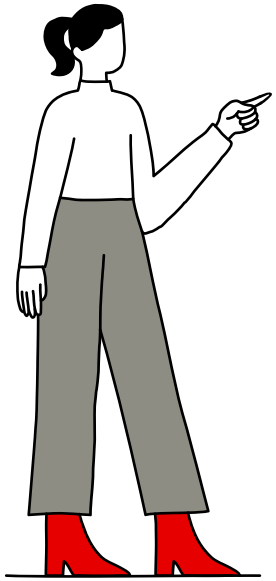
Distinct and overlapping federal and state policy jurisdictions

Major powers and responsibilities



"Primarily state" does not mean exclusive: federal law can also apply. Both levels are subject to constitutional limits and individual rights

Source: UBS, as of 5 October 2026



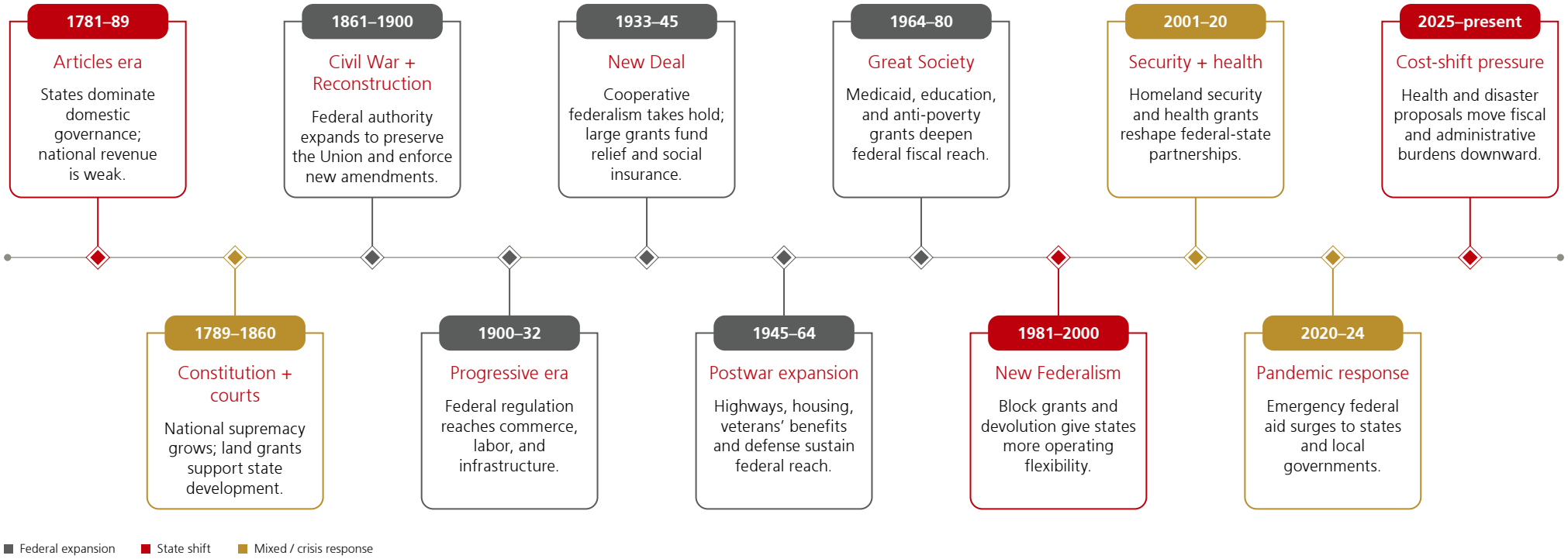
While states are likely to absorb some additional responsibilities, any permanent reduction in federal support will require a combination of timely budget adjustments, tax changes, reserve usage, and program redesign at the state level.

As the federal and state relationship has evolved from largely separate responsibilities into a system of shared funding and service delivery, the lines have more recently become blurred as the federal government actively seeks to shift both administrative and funding responsibilities to states, particularly in health care, disaster recovery, and other social programs. Amid shifting federal-state responsibilities, the following sections examine state revenues and expenses and assess states' capacity to manage the fiscal pressures arising from recently enacted legislation ahead of the midterm elections.

Figure 12

Power and funding in US federalism

A cyclical story of national expansion, state flexibility, and recurring cost shifts



Federal leadership expands during crises and program-building eras; devolution often returns flexibility while shifting costs and administration to states.
Source: UBS, as of October 2026

Strong state revenues amid shifting tax policies and federal uncertainty

Following several years of tax revenue growth, aided by record levels of extraordinary federal fiscal assistance, state credit quality remains among the strongest in the municipal bond market, supported by the substantial resources available to meet debt obligations and fund essential services. A key strength for state credit quality is the broad revenue-raising capacity through taxes, service charges, and other sources. These own-source revenues accounted for an estimated two-thirds of total state revenue, with taxes historically accounting for the largest component (see Fig. 13).

Since 2021, 23 states have reduced top income tax rates, while six states and the District of Columbia have raised them, according to the Tax Foundation. Because tax receipts represent such a significant portion of state revenue, the growing divergence in state tax policy underscores the stakes of public-policy choices at a time when affordability is voters' top concern ahead of the midterm elections. As the cost of health care and social services rises, these differing approaches will test states' ability to balance revenue competitiveness with fiscal sustainability.

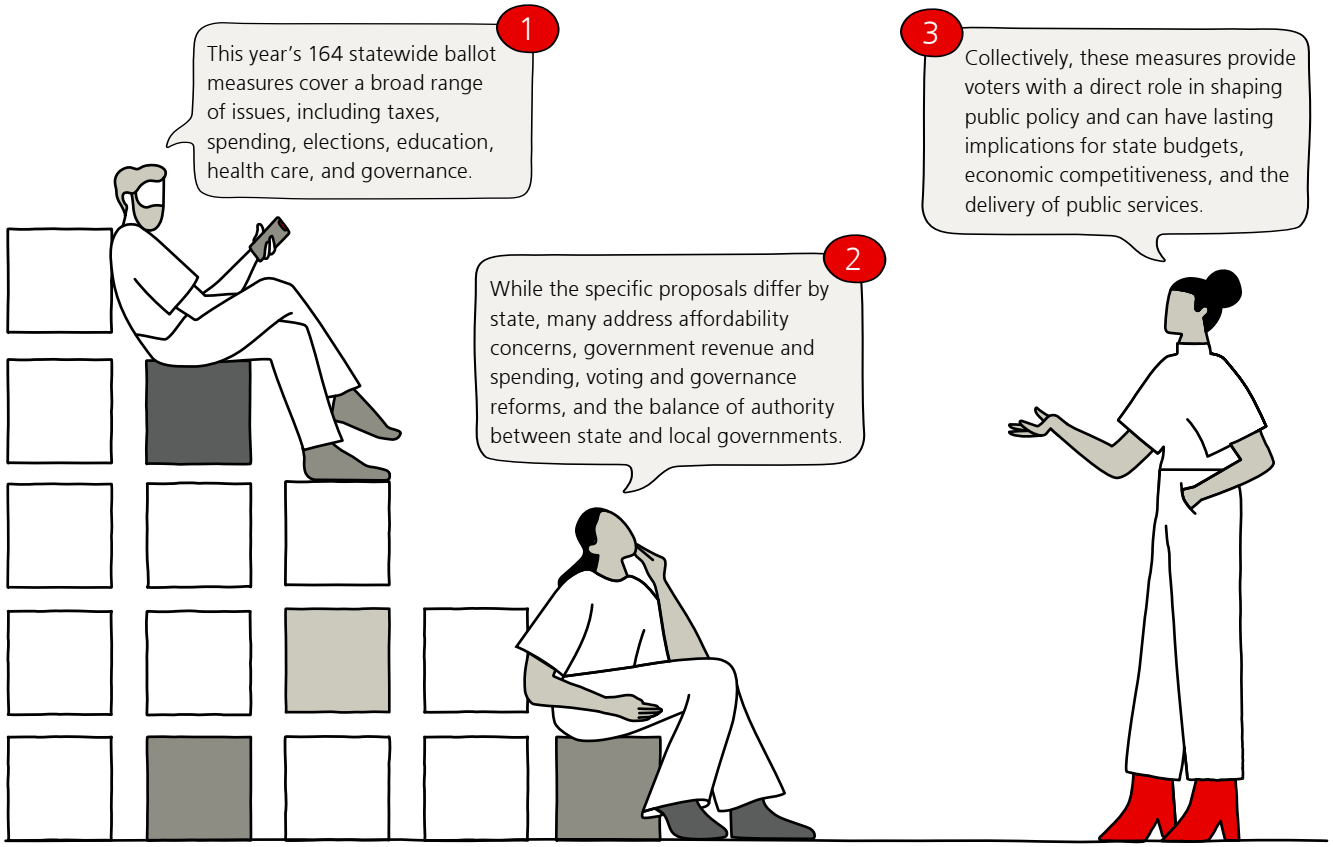
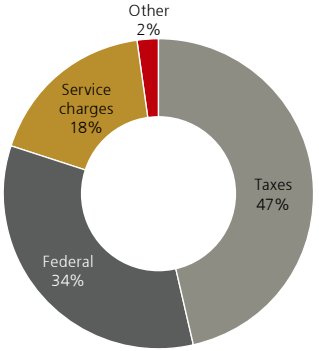


Figure 13

States have strong control over a majority of revenues

State revenues, first look 2024 data



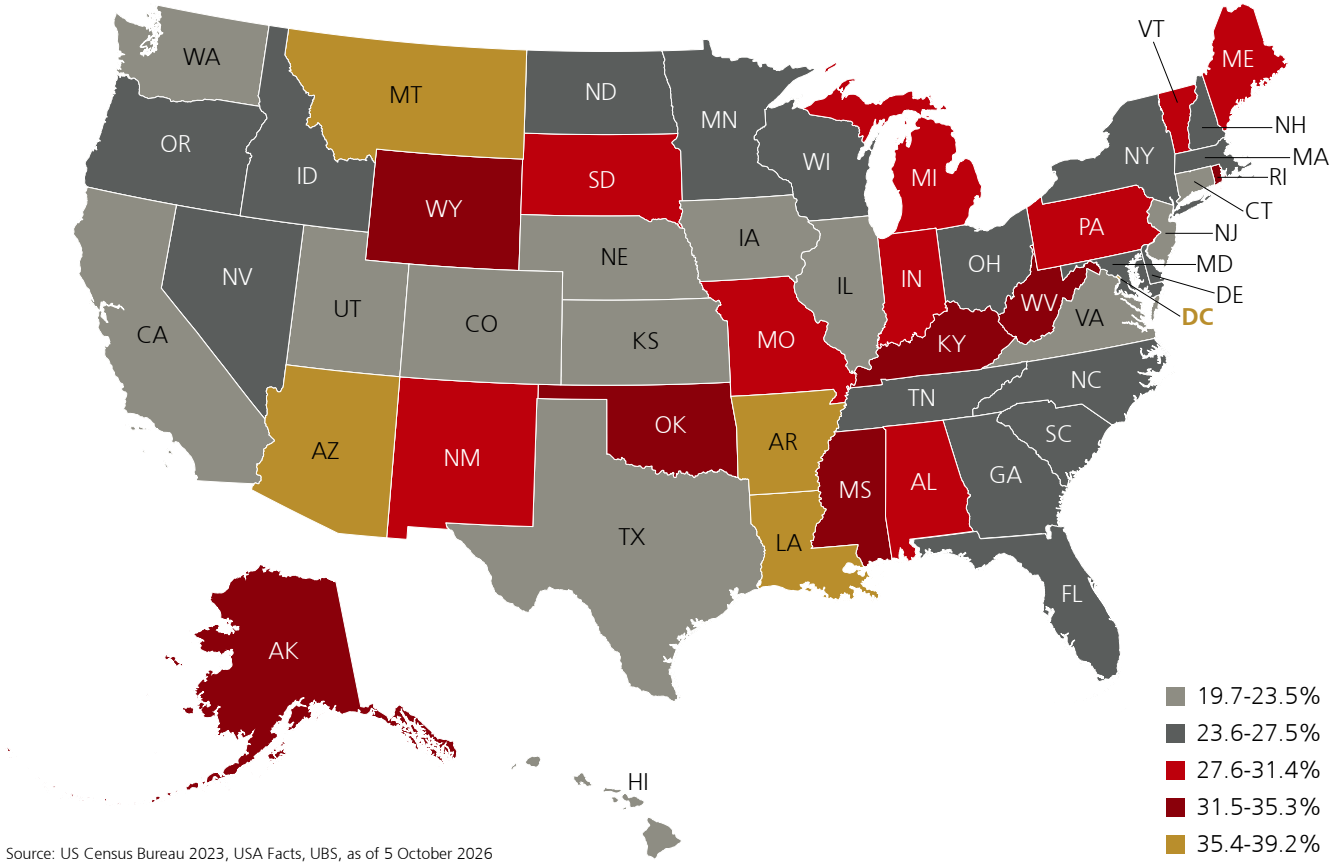
Source: US Census Bureau, UBS, as of 5 October 2026

In recent years, the outlook for state finances has become increasingly clouded by public policy uncertainty and the prospect of reduced federal support, which accounts for roughly one-third of aggregate state revenue. Reliance on federal funding varies considerably by state, ranging from 19-39% (see Fig. 14). Nominal federal funding to state and local governments rose 4% from 2024 to 2025 and held steady as a share of total federal spending at 17% (see Fig. 15). However, this trend is likely to reverse given executive actions and legislation reducing federal funding for state programs, particularly Medicaid and other social programs.

Figure 14

Federal funding varies widely by state

Share of state and local revenue from the federal government, in %

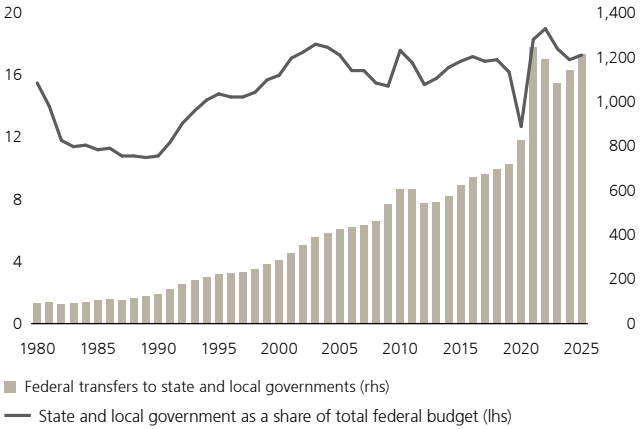


Source: US Census Bureau 2023, USA Facts, UBS, as of 5 October 2026

Figure 15

Federal transfers to governments steady but expect declines

Federal transfers to state and local governments, in USD millions, and state and local government spending as a share of total federal budget, in %



Source: OMB, Historical Tables, Budget of the United States Government, Fiscal Year 2027, UBS, as of 1 October 2026

Rising state spending and shifting federal obligations test fiscal flexibility

State spending broadly supports education, health care, transportation, and social programs—some of which are jointly funded together with the federal government (see Fig. 16). According to the National Association of State Budget Officers (NASBO), fiscal 2025 spending increased for a fourth consecutive year, rising 5.7% to more than USD 3.2 trillion, due in part to higher health care and transportation costs.

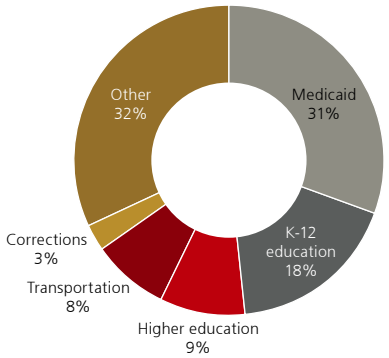
Looking ahead, the July 2025 passage of the One Big Beautiful Bill Act, H.R. 1 (OBBBA), seeks to shift a greater share of health care and safety net responsibilities from the federal government to states through Medicaid funding reductions and increased Supplemental Nutrition Assistance Program (SNAP)-related obligations. The largest quantified impact on states is expected to come from the backloaded reductions in Medicaid spending (see Fig. 17).

The phased implementation of these cuts will give states time to prepare their responses from both a programmatic and financial perspective. While states are likely to absorb some additional responsibilities, any permanent reduction in federal support will require a combination of timely budget adjustments, tax changes, reserve usage, and program redesign at the state level. If appropriate adjustments are not made, the shift could increase long-term budget pressures

Figure 16

State expenses expected to continue growing

State expenses by function, 2025

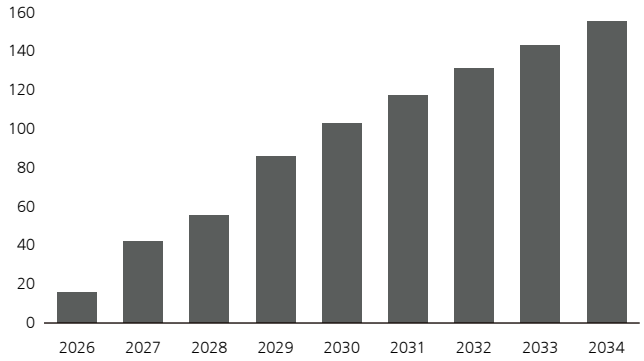


Source: NASBO, UBS, as of 5 October 2026

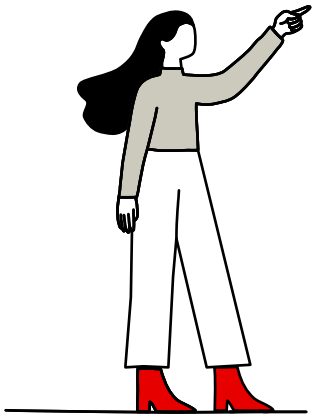
Figure 17

Backloaded spending cuts to Medicaid from OBBBA

Congressional Budget Office estimates of Medicaid spending cuts, in USD billions



Source: CBO estimates on key Medicaid provisions of P.L. 119-21 (H.R. 1), UBS, as of 1 October 2026



Statewide referendums can have significant implications for state and local governments. They are often worth monitoring because they can produce lasting effects on tax revenues, spending priorities, and the fiscal relationship among local, state, and federal governments.

for states, which may also face economic downturns, rising health care costs, and structural fiscal imbalances over a longer time horizon.

Unlike the federal government, which can run deficits and issue debt to finance its operations, state constitutions require balanced budgets each year and typically prohibit borrowing to fund day-to-day operations. These substantial budgetary controls and requirements, as well as states' strong taxing authority, ability to pause capital projects and draw down reserves, enable states to often carry higher credit ratings than that of the federal government.

State ballot measures are catalysts for broader change

Presidential elections, congressional midterms, and most state elections are held in even-numbered years. In addition, many state election laws require ballot measures to appear on general election ballots, resulting in more statewide referendums in even-numbered years, when they coincide with major races and typically draw higher voter participation. Against that backdrop, voters will consider 164 statewide ballot measures in 2026, including 145 measures scheduled for the November election, slightly above the historical average.

Statewide referendums can have significant implications for state and local governments. They are often worth monitoring because they can produce lasting effects on tax revenues, spending priorities, and the fiscal relationship among local, state, and federal governments. Their influence can also extend beyond the state in which they are held, as successful ballot measures frequently serve as policy experiments and signals of voter sentiment at the federal level. When voters in multiple states repeatedly approve similar policies, they provide policymakers with a clear indication of public support. Over time, those outcomes can shape national policy debates and increase pressure on Congress to consider federal legislation addressing the same issues.

This year's 164 statewide ballot measures cover a broad range of issues, including taxes, spending, elections, education, health care, and governance (see Fig. 18). While the specific proposals differ by state, many address affordability concerns, government revenue and spending, voting and governance reforms, and the balance of authority between state and local governments. Collectively, these measures provide voters with a direct role in shaping public policy and can have lasting implications for state budgets, economic competitiveness, and the delivery of public services. Beyond their state-specific impacts, ballot measures often serve as indicators of public sentiment on emerging issues and can influence policy discussions in other states and at the federal level, particularly when similar initiatives gain support across multiple jurisdictions.

As the ongoing debates surrounding data centers and housing affordability illustrate, state legislation and ballot initiatives can influence public policy as much as, and sometimes more than, actions taken at the federal level. In some cases,

Figure 18

Various trending statewide ballot topics

(Remaining measures vary by topic/state/region)

Trending topics	Measures	States
Abortion policy	4	ID, MO, NV, VA
Citizenship requirements for voting	6	AK, AZ, AR, KS, SD, WV
Voter ID	7	AZ, CA, CO, NV, NC, OH, OK
Criminal sentencing, penalties, and bail	6	AL, CO, IN, LA, TN
Housing policy	6	CA, HI, MA, RI
Income and wealth taxes	9	CA, CO, IA, MO, NC, WA
Initiative and referendum process	9	CA, ID, MO, MT, ND, SD, UT
Property taxes	13	FL, GA, LA, NC, OK, TN, WY
Sports eligibility and medical procedures	6	AZ, CO, MO, NE, WA
State constitutional rights	14	AZ, AR, CO, MO, MT, NV, VT, VA, WI

Note: Statewide ballot measures: 145 to be determined 3 November 2026
Source: Ballotpedia, UBS, as of 5 October 2026

states and localities step in when federal policies are perceived as insufficient or when Congress is unable to reach consensus on emerging issues. Data center regulation provides a timely example. While Congress continues to debate proposals such as the Ratepayer Protection Act, a number of states have moved ahead with their own policies, requiring developers to secure dedicated power supplies, conduct impact studies, or meet stricter permitting standards to limit pressure on residential electricity demand and prices. Although a handful of states have explored more restrictive approaches, most have focused on managing growth rather than curbing it. As a result, even if Democrats gain additional control of state legislatures, the bipartisan support for economic development and technology investment suggests that data center expansion is unlikely to slow enough to materially alter planned investment activity.

When the federal government successfully enacts legislation, there can also be more that states can do to advance. With regard to housing, Congress passed legislation in 2026 to help address affordability and supply constraints, but states including California, Texas, Montana, and Washington have also enacted housing reforms, demonstrating how state-level policymaking can support one of voters' most important priorities.

Interestingly, Americans across party lines frequently agree on the issues that matter most, including affordability, education, health care, public safety, energy, and immigration. However, despite this shared set of priorities, the preferred policy approaches for addressing these challenges often differ substantially (see Fig. 19).

Figure 19

Broad gubernatorial issues and party response

Issue area	Democratic approach	Republican approach
Affordability and taxes	Targeted credits, public investment, consumer protections, and expanded services	Broad tax reductions, spending restraint, deregulation, and property-tax limits
Housing	Public financing, zoning reform, affordability requirements, and homelessness services	Faster permitting, fewer regulations, private construction, and enforcement on encampments
Education	Public-school funding, teacher pay, early education and student services	School choice, vouchers, parental rights, and administrative accountability
Health care	Medicaid expansion, rural-hospital support, and lower prescription costs	Competition, price transparency, fewer mandates, and spending controls
Crime and public safety	Community policing, behavioral-health treatment, and prevention programs	More police funding, tougher sentencing, and changes to bail or prosecution rules
Energy and utilities	Renewable generation, transmission, resilience, and consumer protections	Conventional energy production, permitting reform, and lower regulatory costs
Immigration	Services and legal protections for established immigrants; limits on state cooperation with mass enforcement	Cooperation with federal enforcement, border measures, and restrictions on sanctuary policies
Budgets	Preserve core programs while using targeted savings or revenue	Spending limits, program audits, tax cuts, and smaller government

Source: UBS, as of 5 October 2026

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