

# The MacroBriefing

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## America has voted

Donald Trump's support for extreme positions, his provocations and his frequent U-turns imply heightened risk and volatility during the next administration. Even if the realities of office, combined with Congressional pushback, will prevent President Trump from implementing many of his election promises, the deep divisions in American society suggest that politics could become a drag on the US long-term growth outlook. The Fed will delay raising rates until the markets have digested the first post-election shocks. Going forward however, President Trump's policies are likely to increase the federal deficit and at least partially elevate trade barriers. This would over time generate inflationary pressures, the Fed would raise rates and thereby also push up bond yields. Stimulus policies will clearly move from the monetary to the fiscal side.

### The market reaction

Despite the narrowing of the polls in the final week campaigning, the markets had not priced in the full risk of a Trump presidency and will react with a flight to safety and heightened volatility. Equity and corporate bonds will plunge, the currencies of Canada and Mexico as well as other emerging markets will come under pressure. Safe assets of all types will gain, yields on German Bunds will fall while the spread of US Treasuries will rise. The Fed will rethink its December rate rise.

Beyond the initial shock, the markets will wait and see whether President Trump tones down his protectionist and nationalist rhetoric, whom he appoints to key posts and how he will get on with Congress.

### The realities of office

Among President Trump's election promises were major (unfunded) tax cuts, punitive tariffs on the imports from major trading partners and the expulsion of 11 million illegal migrants. Even though

the Republican party controls both houses of Congress, none of this will happen as promised. Key parts of Trump's election manifesto contrast sharply with traditional Republican positions, such as support for free trade, balanced budgets and immigration reform. With a view to the 2018 mid-term elections, Republican members of Congress cannot afford to alienate Trump supporters by blocking his every move. But neither will they allow him to ride roughshod over established conservative values. Most of the Republican party elite will seek to prevent a re-election of President Trump in 2020 so they will strike a balance between obstructing their own president and letting him succeed.

Since President Trump's room for maneuver will be limited, he will initially focus on undoing the policies of the Obama administration, in particular those that the latter has passed through executive orders (trying to circumvent that blocking tactics of a Republican-controlled Congress). Regulatory uncertainty will be the immediate result. Trump has also promised to replace the new universal healthcare system known as Obamacare but

efforts in this respect will be long drawn out at best.

### **The economic and policy outlook**

If President Trump implemented even parts of his election program – say, a partial expulsion of unregistered but previously employed migrants or the introduction of ‘emergency’ tariffs – the impact would be higher inflation, either via wage pressure or higher import prices. The fiscal plans would exacerbate this effect. Higher spending on infrastructure and defense without clear expenditure cuts elsewhere would increase public deficits, all the more so as major tax cuts are planned, that would mainly benefit the better-off who have a lower propensity to consume, so their impact on demand would be limited. At the same time, high uncertainties (e.g. related to legal challenges) and growing protectionism will dampen the US growth outlook.

### **The global impact**

Even if President Trump does not start a trade war, efforts at trade liberalization will stall. TPP will not be ratified and TTIP is highly unlikely to be concluded. The world economy will limp on with an increasingly out of date trade and investment regime. In foreign policy, President Trump has suggested he may desert NATO allies, encourage nuclear proliferation, tear up the Iran deal and seek a rapprochement with Putin’s Russia. Even though such drastic steps look unlikely, the combination of President Trump’s inexperience in international politics and the wide-ranging competencies that the US constitution grants him in foreign policy, make the outlook highly uncertain and dependent on the cabinet members he nominates. Increased geopolitical uncertainty could benefit right-wing parties in other upcoming elections (Netherlands, France, Germany) and dampen investment sentiment. Certainly, Europe will have to become more engaged in geopolitical crisis management.

### **Quo vadis America?**

This election has highlighted the extraordinary deep political, economic and cultural divisions in the US. Political decency has been lost in the

campaign and will be hard to restore. The political system in the US has supported the rise of populism. Many of Trump’s policies could further reinforce already stark income inequalities. As a result, the US is likely to remain deeply polarized. The country’s political effectiveness is unlikely to improve in years to come.



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