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The Economy Under The Trump Administration

CLERMONT WEALTH STRATEGIES

Donald Trump's victory in the November 8th Presidential election marks an acute philosophical shift from prior US Presidential administrations. On the campaign trail, candidate Trump harangued against the heretofore widely accepted global economic model of free and open trade and increased globalization. As he builds his cabinet and prepares to take office, he has indicated that he will push the United States in a different direction, one which will have a profound impact on both the domestic and global economies.

The Trump administration is expected to focus on five core areas that will shape world economies for the next four years and beyond: fiscal policy, monetary policy, regulatory reform, trade policy, and immigration policy. President-elect Trump has signaled that his administration will offer a pronounced shift in US policy, change which we believe will have both positive and negative impacts on economic growth. There is a big difference between promises made on the campaign trail and what can actually be instituted, however. On the following pages we will review the policies that have been put forward by President-elect Trump and his advisors, discuss what can feasibly be enacted, and analyze the impact of the likely outcome on the domestic and global economies.

Fiscal Policy

President-elect Trump's fiscal policy proposal is two-pronged; he seeks to enact sweeping corporate and individual tax cuts coupled with stimulative spending in the form of a large scale infrastructure program. Both programs will be politically achievable. The GOP, which controls both chambers of Congress, has historically favored reducing the tax burden and will not stand in the way of Trump's proposed tax reform plans, though they will help shape the reform that is ultimately passed. Trump will also likely find bipartisan support for his infrastructure spending plan, as Democrats have signaled their willingness to work with the incoming administration on an infrastructure proposal.

President-elect Trump has proposed a simplification of the individual tax code, which would lower rates but also limit deductions; he would, however, increase the standard deduction. He has also called for a repeal of the Alternative Minimum Tax and the Estate Tax. In addition, he has proposed an overhaul of the corporate tax code, which would reduce the corporate tax rate from 35% to 15% and allow for the immediate full expensing of all business capital spending. He has also indicated that he would be open to an overseas tax holiday, which would allow corporations to return cash held overseas at a one-time, lower rate coupled with a move towards a territorial tax system to replace the worldwide system currently in existence. Both House Speaker Paul Ryan and Senate Finance panel chair Orrin Hatch have voiced support for this corporate tax system reform. The nonpartisan Tax Policy Center has estimated that the cost of these tax proposals would, excluding increased interest, increase federal debt by $6.2 trillion over the next decade[1].

President-elect Trump has also called for $550 billion in new infrastructure investment, but details surrounding the plan have been limited. Based on current information, Trump's infrastructure investment plan calls not for outright government spending on projects but for an incentive structure designed to promote private sector investment in infrastructure projects that would be supported by future fees (e.g. tolls). The plan would require an upfront equity investment equal to 17% of a project's costs, with the remainder financed by debt. The government would then provide a tax credit equal to 82% of the upfront equity investment, which would amount to $14 billion for every $100 billion of investment. A key question is whether

[1] Nunns, J. et al, "An Analysis of Donald Trump's Revised Tax Plan", *Tax Policy Center*, October 18, 2016.

this infrastructure spending would represent new spending or simply take the place of municipal debt financed programs. Trump has also called for an elimination of the defense spending reductions put in place through sequestration. Collectively, these programs would add an additional $100-$200 billion to federal debt each year.

While there would likely be a short term increase in US economic growth as a result of these policy changes, that increase is expected to be short lived and be offset by the long-term effects. With no new revenue sources to cover the costs of these plans, the US Debt/GDP ratio is predicted to increase from 77% today to as much as 106% in 2026.[2] While some studies have suggested government revenues would increase along with economic growth under a dynamic model, this increased revenue is not expected to be enough to offset the cost of the programs, which in their absence will necessitate increased government borrowing. This increase in debt will act as a drag on US growth in the long run. In addition, undertaking a stimulus spending plan at a time when the economy is healthy and the unemployment rate is close to or at the natural rate may stoke inflation, which has been trending towards the Fed's target of 2%.

Monetary Policy

We have no reason to believe that the independence of the Federal Reserve is in jeopardy and expect the Fed to remain fully in control of monetary policy under the Trump administration. While President-elect Trump will have little direct control over monetary policy, he does have the power to appoint members to the Federal Reserve Board, which currently has two vacancies. Predicting the leanings of those Trump may appoint is difficult however, because Trump has himself remained an enigma vis-à-vis his monetary policy preferences. He has at times praised the current Fed and low interest rate policies and at others railed against it. Based on Trump's campaign rhetoric, he appears to value economic growth above all else. Knowing his preference for policies that favor growth, he is unlikely to appoint an overly hawkish (in favor of tighter monetary policy) member to the board, cognizant that an aggressive tightening of interest rates would likely snuff out any economic rally his policies may spur.

Aside from his Federal Reserve appointees, Trump will only affect monetary policy tangentially through the economic impact of the policies his administration is able to implement. The Fed will have to respond to the impact of his policy proposals on employment and inflation, the two parts of its dual mandate. The Yellen Fed has indicated that it prefers to take a "wait and see" approach, and is unlikely to start aggressively normalizing interest rate policy until the details and impact of other policy proposals are known. In the past, the Fed has suggested that it may be willing to allow inflation to temporarily overshoot its 2% target, since that target is meant to be symmetric, with misses both above and below the target, and inflation has remained subdued for such an extended period of time. While Trump's administration will differ substantially from the Obama administration, we expect the Fed will remain data dependent and apolitical.

Regulatory Reform

Regulatory reform is expected to be another focus of the Trump administration. On the campaign trail Trump bemoaned the suffocating effect he believes many recently imposed government regulations have had on the economy and promised to loosen the reins should he be elected. As his inauguration nears and his preferred cabinet appointees have been named he appears on track to keep this promise. Initially he is likely to focus on a few key regulations he mentioned time and again on the campaign trail: the Affordable Care Act and Dodd-Frank. His administration is likely to reduce government restrictions across the board as well. The House Freedom Caucus recently sent the Trump transition team a list of 228 federal regulations to review and consider for revocation. The regulations highlighted range from school nutrition programs to the energy efficiency of household appliances to ending the Export-Import Bank. The stated goal is to put power back in the hands of the legislature rather than a diffuse body of federal regulatory agencies. By all indications Trump will be fully on board. He has frequently mentioned that any regulatory agency that wishes to impose a new regulation will have to remove two existing ones in order to do so. While we view this approach as a little short-sighted, and prefer that regulations be analyzed in the context of the costs they impose and the benefits they provide, President-elect Trump has

[2] Nunns, J. et al, "An Analysis of Donald Trump's Revised Tax Plan", *Tax Policy Center*, October 18, 2016.

made it clear that he plans to get government out of the way of business. The business community appears to be highly receptive to the potential for regulatory relief, as small business optimism has soared since Trump's victory.

Many of the targeted regulations were the result of Obama executive orders, and can quickly be reversed by Trump (a prime example is the Deferred Action for Childhood Arrivals program). Others will be subject to the time consuming federal rulemaking process, though many recently introduced regulations can be overturned via the Congressional Review Act, which only requires a simple majority in both the House and Senate. While it may take some time, we fully expect the Trump administration to substantively roll back the bureaucratic regulatory state that many believe has burgeoned under the Obama administration. This should be highly beneficial to small and medium sized businesses, since they are far less able to absorb the costs imposed by many of these regulations than large multinational companies. Overall, a significant reduction in regulatory costs is expected to be positive for economic growth.

Trade and Immigration Policy

The final two areas where the Trump administration will significantly affect the economy are trade and immigration policy. Candidate Trump made two things abundantly clear at his raucous campaign rallies: he was going to bring our jobs back from overseas and he was going to build a wall on the border with Mexico – and make Mexico pay for it. In our estimation, he will do neither. In fact, after his victory he has already backed down from a few of his more inflammatory proposals on immigration. And while Trump's intervention to keep some jobs at a Carrier plant in Indiana that were slated to move to Mexico made for good press, we don't expect the President of the United States to personally intervene every time a company shifts production overseas.

President-elect Trump's trade proposals stand in stark contrast to 60-plus years of establishment economic consensus, but Trump rode a wave of populist economic anxiety into office and his voters will expect him to deliver on his campaign rhetoric. While Republicans will control the White House and both houses of Congress, we expect Trump will face staunch opposition from fellow Republicans to his trade proposals, given that they fly in the face of decades of Republican orthodoxy. Trump has called for an immediate withdrawal from the Trans Pacific Partnership (TPP), a renegotiation or withdrawal from NAFTA, designating China as a currency manipulator, the imposition of stiff tariffs on imports from China and Mexico, and has even called for the possible withdrawal from the World Trade Organization. All of these proposals would likely negatively impact US economic growth.

Our withdrawal from the TPP would be a win for China above all else. Though they were not included in the agreement, our departure from an important regional trade pact provides an opportunity for China to step in and play the key role in establishing a regional economic trade zone, which they are likely to do in our absence. China has increasingly been taking a larger economic role in the region, and our withdrawal would provide an ample opportunity for the Chinese to increase their economic power both regionally and globally. A withdrawal or renegotiation of NAFTA would result in decreased trade with our second and third largest trading partners and our two largest markets for exports. Leaving the WTO would deprive us of the major international organization through which we are able to arbitrate trade disputes and would represent a substantial blow to the global international economic order. Labelling China a currency manipulator would likely result in retaliation from the Chinese and is largely a symbolic act with no real punitive measures. Tariffs, such as those Trump has floated on imports from China and Mexico, are inflationary in nature, and while they may result in a slight boost to US growth as domestic providers substitute for foreign ones, the inflationary impact would offset any growth resulting in overall lower real economic growth.

If implemented, Trump's trade proposals would serve to weaken both domestic and global economic growth. Most are expected to face stiff resistance from Congress, and are unlikely to be implemented without substantial changes. We believe it is more likely that Trump has staked out these positions so harshly as a negotiation tactic, and will likely soften his views during the negotiation process. That having been said, President-elect Trump has made it clear that he is suspicious of free trade and will push for terms that he believes are more beneficial to the United States.

President-elect Trump's immigration proposals are also expected to undermine US economic growth. Population growth is a key component of the economic growth equation, and the fall in the birth rate over the past several decades has left the United States at a demographic disadvantage. Immigration is a necessary component of economic growth, and policies limiting immigration will result in lower potential economic growth going forward. President-elect Trump has proposed a freeze on green card issuance, new restrictions on H1-B work visas, and the implementation of a nationwide "e-verify" system. Collectively it is estimated that these policies would prompt 2.5 million immigrants to leave the country during the first two years, which would meaningfully decrease growth potential.[3] As this issue was one of the main pillars of Trump's campaign, it is doubtful that he would fail to pursue it once in office. He will face vigorous opposition from Democrats and even some in his own party however, suggesting that actual policy, if implemented, will take a much softer form than the proposals currently on the table.

Adding It All Up

If enacted in full, Trump's policy proposals would most likely provide a short-term boost to US economic growth but result in lower growth over the long-term. The combination of lower taxes, reduced regulatory burdens, and fiscal stimulus should, if enacted, increase US economic growth in the short-term (2017-2019). Longer term, Trump's proposals are likely to be a drag on growth due to increasing government deficits and debt load, decreased immigration, and the potential impact of retaliatory tariffs. Trump's policies may be implemented in full, in a benign combination, or an adverse combination. Full implementation or an adverse combination would result in lower long run growth potential. A benign combination, with only those policies that are positive for growth being implemented, would be best for economic growth in the long-term and represents our preferred scenario. Given that Trump has no track record in government to provide guidance, we face substantial uncertainty regarding the incoming administration. One thing is certain however – change is coming to Washington.

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Proposed Policy	Impact on GDP Growth	Impact on Debt/Deficit
Individual Tax Reform	● (green)	● (red)
Corporate Tax Reform	● (green)	● (red)
Infrastructure Program	● (green)	● (red)
Tighter Monetary Policy	● (red)	● (red)
Regulatory Reform	● (green)	● (yellow)
Renegotiation of Trade Deals	● (red)	● (yellow)
Imposition of Tariffs	● (red)	● (green)
Immigration Restrictions	● (red)	● (yellow)

[3] Hatzius, J. et al, "US Economics Analyst: Economic Implications of the Trump Agenda", *Goldman Sachs*, November 12, 2016.

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