ISSN: 2241-4851

Eurobank Research

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GLOBAL & REGIONAL FOCUS NOTES

Trump: Strategies of Tension

An assessment of the economic impact of the president elect's policy proposals

- Trump in stronger position than at start of first term in 2017
- Markets currently betting on higher US inflation and Fed interest rate path
- Has proposed a more protectionist trade policy, closely associated with the "America First" agenda
- Promised stricter immigration policy, to protect American jobs, reduce illegal immigration, and strengthen national security
- President-elect has proposed a more expansionary fiscal policy; seen as a boost to GDP growth, while concerns about US long-term fiscal sustainability might intensify
- Wants European countries to take on more responsibility for Ukraine defence, raise their own defence spending
- Rollback of environmental regulation could lead to more oil and gas production

Introduction

The immediate focus after Donald Trump assumes the US presidency for a second time on 20 January 2025 will probably be on immigration, having promised during the election campaign that he will carry out mass deportations of undocumented workers, one of several Trump policies that will have deep macroeconomic impacts for the US and the world. His tariff policy, closely associated with the "America First" agenda, could be even more consequential on a global scale, potentially increasing trade protectionism if he follows through on his campaign pledges.

Whether he does follow through is the big question that hangs over this transition period. If he wants to, he will. Trump is in a much stronger position than he was when he first won office in 2016 – the Republican party controls all three levers of government after their election sweep meant they also flipped the Senate while retaining the House of Representatives; he has consolidated his grip over the party to the point where he is now in a position where he can staff all key positions in his administration with MAGA loyalists; and he has the added legitimacy of winning the popular vote, something that eluded him in 2016.

Contributing Authors:

Marcus Bensasson
Research Economist
mbensasson@eurobank.gr

Paraskevi Petropoulou
Senior Economist
ppetropoulou@eurobank.gr

October 2024

However, Trump's style of governance during his first term also led to the common observation that the things he says should be "taken seriously, but not literally".[1] This could be particularly relevant when it comes to trade policy, where the president elect's transactional approach suggests there might be off ramps for an extreme scenario to be averted.

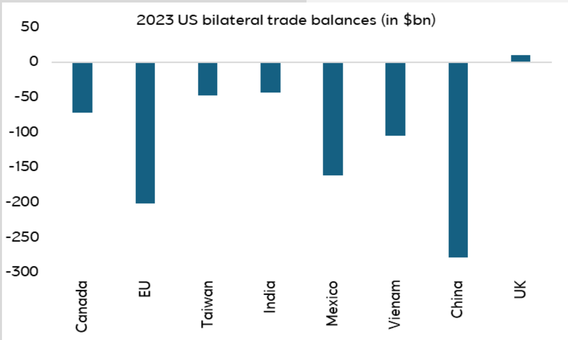
In any case, below is an outline of the key aspects of Trump's proposed policy agenda that could have implications for both the US and the global economy. If we do take his proposals literally, several of these point to inflation reaccelerating – although this could be partially offset by downward pressure on oil prices – and a higher path from the Federal Reserve for US interest rates. In addition, promises for deregulation in several sectors could support growth and push prices down by reducing compliance cost. Those factors explain the "Trump trade" currently favoured by markets, which is driving up the USD and US equities while pushing down Treasuries and other countries' equities.

Trade Policy and Protectionism

As president, Trump will have considerable authority to modify trade policy unilaterally using existing powers granted by various statutes, which enable such actions without the need for Congressional approval. His return to the presidency could see an intensification of the trade war between the US and its trading partners, reshaping global supply chains in favour of US domestic production. He has proposed raising tariffs on Chinese goods from 25% currently to at least 60%, along with implementing tariffs of 10% to 20% on imports from all other countries. In response to this threat, several of the US's trading partners might seek to negotiate concessions to ease tensions. However, if these efforts are rejected, retaliatory measures are likely to follow.

The imposition of higher tariffs could be seen as a policy shock, potentially leading to temporarily higher inflation, and lower output both in the US and globally. In the medium to long term, the impact would depend on how these policies distort resource allocation, as well as the degree to which trade policy uncertainty and strained relations with trading partners influence business and consumer confidence. However, as seen during the first Trump administration, the threat of higher tariffs could be used as a negotiating tool to extract concessions from trading partners. This implies that certain countries might be exempted, or the actual tariff increases could be less severe than originally proposed during the election campaign. Countries that rely heavily on exports to the US would be especially vulnerable.[2] A recent study by a German economic institute estimated that in a scenario

The US runs a bilateral trade deficit with nearly all major trading partners



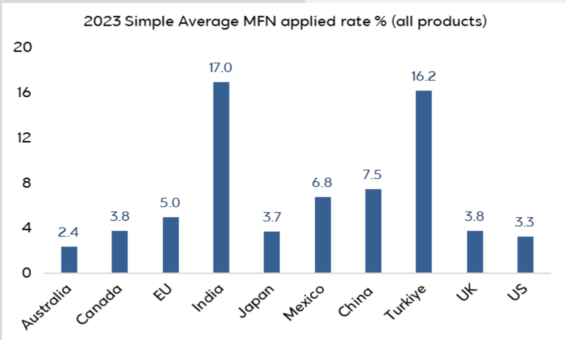
Source: BEA, Eurobank Research

[1] This is a phrase that first appeared in an article for The Atlantic to contrast the way his supporters and the media interpreted his comments – the quote being "the press takes him literally, but not seriously; his supporters take him seriously, but not literally" – and was quickly taken up by allies including Peter Thiel. https://www.theatlantic.com/politics/archive/2016/09/trump-makes-his-case-in-pittsburgh/501335/

[2] Those countries where exports to the US account for more 10% of the total include China, Canada, Mexico, Germany, India, South Korea, Japan and Vietnam.

where the US increases tariffs on Chinese goods to an average 60% and imposes a 10% tariff on imports from all other economies, with China retaliating by increasing its tariffs on US imports to 40%, global GDP could fall by 0.6% in 2025 relative to its baseline, and by around 1% annually in 2026-2028.[3] The same study also estimates that US GDP could drop by 1.1% in 2025 relative to the baseline scenario, with annual reductions ranging from 0.06% to 1.4% between 2026-2028, depending on the extent of retaliation. For Germany, the projected GDP impact is a decrease of 0.3% in 2025 and a potential annual decline of 0.9% to 1.4% in 2026-2028. A more protectionist trade policy is closely associated with the "America First" agenda, which emphasizes bringing production back to the US, especially in industries that have been adversely impacted by globalization and outsourcing. This shift aims to boost domestic manufacturing output, create new jobs, raise real disposable income and stimulate GDP growth, all of which would generate additional government revenue. By increasing the production and consumption of US-made goods, the policy could also help reduce the US trade deficit and lessen the country's reliance on foreign nations, providing greater resilience against potential supply chain disruptions. For US trading partners, higher tariffs may initially cause economic challenges, but over time, they could lead to positive outcomes. In response to more US protectionism, vulnerable countries may seek new trading partners or strengthen existing trade agreements (such as the CPTPP and RCEP), which could bolster their supply chains. They can also form strategic alliances with other nations, building stronger partnerships and enhancing their collective bargaining power. Additionally, countries that benefit from lower or no tariffs from the US. may capture a larger market share, stimulating their own economic growth and job creation.

The US has lower tariff rates on average compared to several trading partners



Source: WTO, Eurobank Research

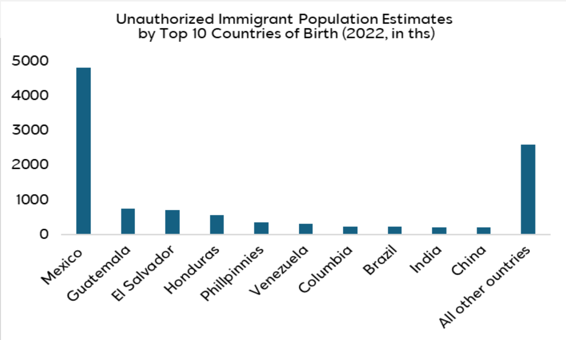
Immigration Policy

Trump called during the election campaign for stricter immigration policy, including large-scale deportations of undocumented workers, ending birthright citizenship, and expanding the US-Mexico border wall. The president elect argued that these measures were necessary to protect American jobs, reduce illegal immigration, and strengthen national security. According to data from the U.S. Census Bureau, the foreign-born population in the US has grown considerably in both size and share of the population in recent years. In 2022, foreign-born individuals made up 13.9% of the US population (46.2mn), up from 12.9% (40mn) in 2010. The same data shows that net international migration peaked at 3.3mn in 2023, driven in part by an increase in asylum seekers and refugees who were granted work permits while awaiting court hearings, a pace roughly three times higher than the annual flow during the 2010s. A reduction in migration flows could have negative economic consequences, potentially slowing economic growth and even fuelling inflation as

[3] IW. What if Trump is re-elected? Trade policy implications, March 2024, https://www.iwkoeln.de/en/studies/thomas-obst-juergen-matthes-samina-sultan-what-if-trump-is-re-elected.html. This study is indicative out of many such examples conducted by multilateral organization and think tanks

reduced labour supply in key sectors could lead to wage increases, particularly in industries that rely heavily on immigrant workers. However, recent polls indicate that an increasing number of Americans are prioritizing concerns about rising immigration. Many, particularly in lower-wage sectors, fear that immigrants — especially undocumented ones, estimated at around 11mn — may take jobs away from native-born workers or depress wages. Additionally, some areas with high immigrant populations, particularly undocumented workers, may experience strain on public resources, infrastructure, and social services. At the same time, the presence of undocumented immigrants has raised issues related to crime, national security, and border control, particularly in regions with high numbers of border crossings.

Undocumented immigrants are estimated at around 11mn, mainly coming from Mexico

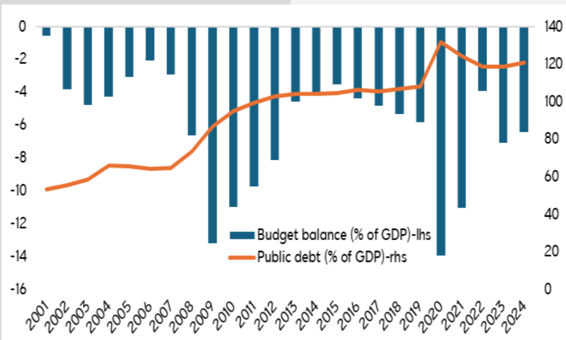


Source: Office of Homeland Security Statistics, Eurobank Research

Fiscal policy

Trump has proposed extending the individual tax cuts from the 2017 Tax Cuts and Jobs Act (TCJA), which are set to expire in late 2025 (the TCJA lowered the corporate tax rate from 35% to 21% and introduced significant cuts to personal taxes). He has also called for a further reduction in the corporate tax rate to 15%. Additionally, the president-elect has proposed increased military spending, enhanced border security and greater support for housing, health care, and long-term care as well as eliminating taxes on tip income, overtime pay, and social security benefits. The federal budget has been in deficit since 2001, and the Congressional Budget Office's (CBO) most recent forecasts have the deficit remaining at high levels over the next decade.[4] Under its baseline scenario, the CBO projects the deficit at around 7% of GDP by 2034, significantly higher than an average deficit of 3.7% over the past 50 years. If Trump's proposed fiscal measures were fully implemented, concerns about US long-term fiscal sustainability would intensify, including the potential for crowding out private investment. In this scenario, the CBO estimates that the deficit would climb to 9.7% of GDP by 2035, which would lead to a sharp increase in public debt, up by $7.75trn, to 143% of GDP, compared to the baseline scenario of around 107-110% with also negative repercussions for refinancing costs and the USD's role as a reserve currency.[5] Expectations of a more expansionary fiscal policy, which is likely to

Trump's proposed fiscal policy would intensify US long-term fiscal sustainability concerns



Source: Federal Reserve Bank of St. Louis, IMF, Eurobank Research

[4] An Update of the Budget and Economic Outlook: 2024-2034, June 18, 2024, Congressional Budget Office, https://www.cbo.gov/publication/60039

[5] The Fiscal Impact of the Harris and Trump Campaign Plans, October 28, 2024, Congressional Budget Office, https://www.crfb.org/papers/fiscal-impact-harris-and-trump-campaign-plans

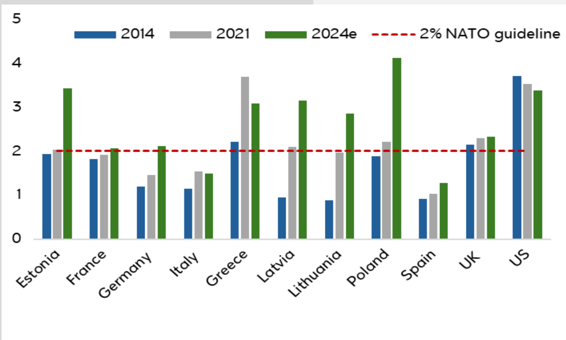
lead to increased Treasury issuance, along with concerns about inflation, have driven yields sharply higher in recent weeks. As of November 15, the 10-yr Treasury yield surpassed 4.50% for the first time in five months, rising more than 20bps since the November 5 US. elections. On the other hand, US equities have surged, supported by strong US economic fundamentals and expectations of lower Fed rates. In addition, potential for tax cuts and a more expansionary fiscal policy is seen as a boost to GDP growth, with the S&P 500 briefly rising above 6,000 for the first time ever, up more 23% since the beginning of the year.

Regarding the monetary policy outlook, stronger domestic demand driven by a more expansionary fiscal policy, combined with supply-side shocks from higher tariffs and reduced immigration, would likely prompt the Fed to shift to a more hawkish stance. This would result in interest rates being kept higher than currently expected, especially from 2026 onwards, assuming any issues related to the US federal debt limit have been addressed before the 2 January 2025 deadline. However, a factor to look out for here is on the continued independence of the Fed. Trump often has criticised Fed Chair Jerome Powell and may wish to replace him with someone he considers more amenable. If he does, that might be challenged in court since Powell's term as Fed chair does not expire until 2026. At the press conference following the Fed's policy meeting two days after the election, Powell said when questioned on the subject that he would not resign if Trump asked him to.

NATO defence spending, Russian-Ukraine war

The Republican clean sweep raises important questions about the US's commitment to NATO and European security, including the extent of its support for Ukraine. Trump has long been a vocal critic of NATO, accusing European members of failing to meet the alliance's defence spending target of 2% of GDP. By contrast, the US contributes around 3.5% of its GDP, making it the largest contributor to NATO. During his election campaign, the president elect warned that the US would only defend NATO countries from Russian aggression if they meet this defence spending target, effectively undermining the principle of collective defence enshrined in Article 5 of the NATO treaty, which holds that an attack on one member is considered an attack on all. In reality, European NATO members have been steadily increasing their defence budgets over the last decade, especially after Russia's 2022 invasion of Ukraine. NATO now estimates that 23 of its 32 members will meet the 2% target this year, a major improvement from just three countries a decade ago. However, reports suggest that the new US president may push for an even higher defence spending target, potentially raising it from 2% to 3% of GDP. This would place additional fiscal pressure on European nations.

NATO's European members have increased defence spending over the last decade



Source: NATO, Eurobank Research

Trump has also repeatedly criticized the level of US aid to Ukraine, arguing that European nations should take on more of the responsibility for Ukraine's defence. So far, the US has committed around $175bn in aid to Ukraine, accounting for nearly half of total international assistance. Given Trump's ongoing criticism of US involvement in foreign conflicts, and his focus on reducing the US financial burden, there are concerns that he might seek to reduce or even halt US military and financial support for Ukraine. Such a shift would raise questions about how Europe would respond to security challenges, especially in the absence of a unified European army or a common defence policy. It would also create significant difficulties for Ukraine and its allies if European nations are either unable or unwilling to fill the funding gap left by the US.

Deregulation, Energy and Environmental Policy

When President Joe Biden took office in 2021, one of his first major actions was rejoining the Paris Agreement, reaffirming the US's commitment to reducing greenhouse gas emissions and tackling climate change. This commitment was further reflected in the Inflation Reduction Act (IRA), signed into law in August 2022, which allocated around $300bn to combat climate change and accelerate the transition to clean energy, mainly by providing tax incentives for renewable energy, electric vehicles and clean energy manufacturing. However, Trump has voiced strong criticism of the IRA's climate provisions, describing these measures as costly and burdensome for businesses. These critiques have raised questions about the direction of climate policy under a Trump administration. As president, Trump might seek to restrict or eliminate many of the IRA's clean energy and manufacturing tax incentives, reversing efforts to curb carbon emissions and promote renewable energy development. Such a shift could potentially undermine international efforts to address climate change and slow the US's progress toward meeting its own climate targets. In addition to scaling back clean energy regulations, Trump is expected to prioritize policies that promote greater energy independence. This might involve increasing domestic oil and gas production, particularly shale, with the goal of reducing reliance on OPEC and foreign energy imports. In an environment of weak global demand, this scenario could contribute to lower oil prices and/or significant supply cuts by OPEC, given that the US is the world's biggest oil producer.

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Research Team

Dr. Tasos Anastasatos | Group Chief Economist
tanastasatos@eurobank.gr | + 30 214 40 59 706

Marcus Bensasson
Research Economist
mbensasson@eurobank.gr
+ 30 214 40 65 113

Dr. Stylianos Gogos
Research Economist
sgogos@eurobank.gr
+ 30 214 40 63 456

Maria Kasola
Research Economist
mkasola@eurobank.gr
+ 30 214 40 63 453

Dr. Konstantinos Peppas
Research Economist
kpeppas@eurobank.gr
+ 30 214 40 63 520

Paraskevi Petropoulou
Senior Economist
ppetropoulou@eurobank.gr
+ 30 214 40 63 455

Dr. Theodoros Rapanos
Research Economist
trapanos@eurobank.gr
+ 30 214 40 59 711

Dr. Theodoros Stamatiou
Senior Economist
tstamatiou@eurobank.gr
+ 30 214 40 59 708

Michail Vassiliadis
Research Economist
mvassileiadis@eurobank.gr
+ 30 214 40 59 709

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