



**BERENBERG**

PARTNERSHIP SINCE 1590

Holger Schmieding, Chief Economist | Holger.schmieding@berenberg.com | +44 20 3207 7889

## TRUMP IN THE LEAD: SERIOUS UNCERTAINTY AHEAD

### Berenberg Macro Flash

Donald Trump will be the next **US president**. Republicans have also won the Congressional elections, keeping a significant majority in the **House of Representatives** and winning the **Senate** as well.

#### SERIOUS UNCERTAINTY

- Donald Trump's apparent victory comes as a significant surprise as Hillary Clinton had been modestly ahead in almost all opinion polls before.
- After the UK vote for Brexit on 23 June, this is the second major upset victory for anti-establishment populists in the Western world this year. It does not bode well for votes to come elsewhere, including some key votes in Europe. The echoes of the populism and protectionism of the late 1920s and 1930s are still faint, but they are now a little less faint than before.
- Trump's outspoken and erratic behaviour during and before his election campaign raises serious concerns that he may upset US foreign policy, weaken NATO and brand China as a "currency manipulator" in a prelude to a potential trade war against China. If so, this would matter more for Europe than the US. Europe needs a firm commitment to NATO to deter further attacks of Russia's Putin on neighbouring countries and is heavily dependent on world trade and hence on respect for the rules that underpin world trade.
- The US has had controversial commanders-in-chief before. In Europe, Ronald Reagan had been widely perceived as a risk to peace before he came to office. He turned out to be one of the more successful US presidents instead. However, Reagan had been an accomplished governor of California first whereas Trump has no executive experience in public office. Also, Reagan represented the sunny optimism of hope rather than the [politics of anger](#) espoused by Trump. Whether the concerns about president Trump will turn out to be vastly overdone will be impossible to know for a while.
- US politics is a system of checks and balances. For most issues, a president has to work closely with Congress that passes laws and makes tax-and-spending decisions. The powers of the president are strongest in foreign policy, some aspects of trade policy and domestic regulations.
- Because of his somewhat erratic behavior, a lack of detail in his policy platform and fiscal promises that simply do not add up, projecting what a president Trump may really get done is difficult.
- Once elected, US presidents frequently get side-tracked or run into political obstacles and tend not to follow their campaign platforms. Political compromise and the heavy weight of the Washington bureaucracy dilute proposals. But whether a more presidential and diplomatic Trump will emerge is an open question, to put it mildly. It is part of the period of elevated uncertainty.
- Having won on election promises that will be virtually impossible to keep, Trump runs the risk that his voters may be seriously disappointed by the very meagre results, if any, that he may be able to deliver. The US policy debate could remain rancorous as a result, to phrase it in a charitable way.
- Whereas some of his regulatory and tax proposals could strengthen the US supply side somewhat, Trump's strongly protectionist leanings could significantly damage US trend growth in the US and some of its trading partners over time. It could also set a bad example for other countries.
- If financial markets tank badly for a protracted period of time and if uncertainty weighs on economic indicators, the question whether the Fed will raise rates in December would be more finely balanced.

#### TRUMP AS PRESIDENT

Trump will arguably move to the White House as one of the most divisive presidents ever. He seems to be highly controversial even among a chunk of traditional Republican voters and, even more so, among many Republican members of Congress.



## MACRO NEWS

A Republican-controlled House of Representatives will pose many challenges and obstacles to the enactment of Trump's economic initiatives. While the Republican leadership favors tax reform, it also tilts decidedly toward fiscal responsibility and would be tough on legislative proposals that would increase budget deficits. The result would be a significant moderation of Trump's policy initiatives.

Many of Trump's economic proposals lack programmatic details and his budget numbers either do not add up or they are based on very optimistic growth projections and outsized economic responses to proposed changes in policies. Trump's proposal for corporate tax reform calls for a sharply lower tax rate and broader base, but provides insufficient details on how the base would be broadened. The Republican-controlled House would force Trump to moderate his tax and spending initiatives, provide programmatic details in place of the gaping holes in his current proposals and require that the budgetary numbers add up and not generate substantial increases in deficit projections. The Congressional Budget Office's scorekeeping of the proposals and Congress's assessment of what is an acceptable path of deficits are critically important.

### **FISCAL STIMULUS**

A moderate increase in infrastructure spending seems on the cards. This will extend well beyond "roads and bridges" and include air traffic control systems, the electrical grid, transportation systems and ports, oil and gas pipelines, cybersecurity and a wide range of public goods (see [US infrastructure spending – a roadmap for thinking broadly](#), October 24, 2016). Moderate increases in defense spending seem likely. Increasing spending for infrastructure and defense upgrading would involve fiscal stimulus and add directly to government purchases and GDP, as well as private sector employment. The legislative process on such fiscal initiatives will involve a wide array of Congressional appropriation committees as well as the budget and finance committees. In light of their comprehensive nature, policy deliberations may be lengthy, and immediate enactment should not be expected.

### **BAD NEWS FOR FOREIGN TRADE**

Trump has emphasised in his election campaign that he would seek to substantially renegotiate the NAFTA trade agreement with Mexico and Canada – and perhaps even abrogate it with a six-month notice if he doesn't get his way. Whether or not he could actually do so without a vote in Congress seems to be an open question which the Supreme Court may have to rule upon. That he will ask Congress to ratify the TPP agreement between the US and 11 other Pacific rim nations or negotiate a TTIP trade agreement with the EU looks highly unlikely. Instead, the election victory of Trump could exacerbate what so far has been a rather restrained trend towards more protectionism in the Western world. The result will be slower potential growth.

### **FED: TROUBLE AHEAD**

As long as the post-election uncertainty does not morph into a major economic calamity, the Fed may still raise interest rates by 25bp on 14 December 2016. If the economy stays on track, we would look for two further such rate hikes each in 2017 and 2018. Gradual gains in wage inflation and a likely modest fiscal stimulus to come support the case for a cautious scaling down of the Fed's monetary stimulus. But the outlook is now in more doubt than before.

Trump has called for a change in leadership at the Fed. This may now raise big concerns in financial markets and at the Fed. However, Janet Yellen's 4-year term as Chair runs through February 2018. While Trump could ask Yellen to step down or publicly criticise her leadership at the Fed, she would not be required to



**BERENBERG**

PARTNERSHIP SINCE 1590

## MACRO NEWS

resign. We expect her to choose to serve out her term as Chair even under adverse circumstances. The costs of doing otherwise may jeopardise the Fed's credibility as an independent central bank.

There are currently two vacancies in the Fed's Board of Governors. President Obama has nominated two candidates to fill the posts, but the Senate Banking Committee (SBC) has postponed confirmation hearings until the Fed appoints a Vice Chair of Supervision as required by the Dodd-Frank act. Trump will almost certainly nominate two different candidates. If Republicans indeed maintain control of the Senate, the SBC would quickly hold hearings and likely confirm the nominees.

The discussion above draws heavily on the analysis by Mickey Levy and Roiana Reid *US elections: policy uncertainties abound*, September 16, 2016.

For a general discussion of the rise and likely fall of the [politics of anger](#), [click here](#).

This message has been produced for information purposes for institutional investors or market professionals, it is not a financial analysis within the meaning of § 34b or § 31 of the German Securities Trading Act (Wertpapierhandelsgesetz), no investment advice or recommendation to buy financial instruments. The message does not claim completeness regarding the information on the developments referred to in it. On no account should it be regarded as a substitute for the recipient's procuring information for himself or exercising his own judgements. The message may include certain descriptions, statements, estimates, and conclusions underlining potential development based on assumptions, which may turn out to be incorrect. Berenberg and/or its employees accept no liability whatsoever for any direct or consequential loss or damages of any kind arising out of the use of this message or any part of its content. -- For full economics reports please visit our website or contact [capitalmarkets@berenberg.de](mailto:capitalmarkets@berenberg.de).

Joh. Berenberg, Gossler & Co. KG  
60 Threadneedle Street  
London EC2R 8HP  
Phone +44 20 3207 7878  
[www.berenberg.com](http://www.berenberg.com)  
[holger.schmieding@berenberg.com](mailto:holger.schmieding@berenberg.com)