The Philadelphia Inquirer
philly.com

A better economy under Trump seems unlikely

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Updated: November 27, 2016 — 3:01 AM EST

ANDY WONG / Associated Press
Shoppers browse at a Beijing mall. China could be ruled a currency manipulator once Donald Trump becomes president. That might mean higher tariffs.

Americans voted for change when they made Donald Trump president, and they are going to get it. What this means for the economy is uncertain, but under most scenarios, it ultimately will be diminished.

Financial markets have adjusted surprisingly well to the prospect of a President Trump, at least so far. Stock prices have rallied, the value of the U.S. dollar has strengthened, and interest rates have jumped.

Investors expect the Trump administration to adopt an expansionary fiscal policy. That means deficit-financed tax cuts and increased government spending.

With the economy near full employment, investors anticipate inflation to pick up and the Federal Reserve to increase interest rates more quickly. Outsize gains in financial and health-care stocks imply that investors also believe Trump will scale back Dodd-Frank regulatory reform and Obamacare.

If financial conditions hold firm, the election should have little immediate economic fallout. It also helps that Mr. Trump is inheriting a fundamentally strong economy. Job creation remains robust, and with near-record open job positions and few layoffs, it would take a severe shock to derail things.

But how well financial markets and the economy hold up in the coming year will depend on how quickly the new administration articulates and implements its economic policies. The Trump campaign wasn't very forthcoming about those policies, likely in part because they weren't well-developed. The campaign's economic-policy team was thin, as nearly all establishment Republican economists decided not to participate.

And it remains unclear who will take the key policy positions in the administration, let alone where the teams of economists, financial analysts, and lawyers needed to formulate legislation will come from. They will come, but it could take an uncomfortably long time, particularly for impatient financial markets.

Still, a Republican-controlled House and Senate will smooth the way for more policy to become law, particularly since the Senate filibuster is no longer the legislative fetter it used to be. The president also has significant authority over trade and immigration policy.

So what will economic policy be under President Trump? It is highly likely that two pending trade deals, the TTP with the Pacific Rim and the TTIP with Europe, will be shelved. Labeling some countries, such as China, currency manipulators can't be ruled out. Presumably this would result in some form of action, such as higher tariffs.

It is a good bet that fewer immigrants will be allowed to come and stay. To satisfy his campaign pledge to require the undocumented to leave the country, President Trump will increase enforcement and may more aggressively implement the e-verify program used by employers to determine whether potential employees have appropriate work visas.

Tax cuts seem likely, albeit with a much smaller price tag than he proposed during the campaign. The corporate tax code will probably also be brought more in line with those of other countries, and there will be a one-time lower tax rate for repatriation of foreign profits now held overseas. More government spending on veteran benefits and the military seem likely, and while more infrastructure spending isn't as sure, given skepticism among some congressional Republicans, President-elect Trump is openly supportive of it.

It is difficult to see how President Trump will pay for his tax and spending policies. They will likely add significantly to the government's already uncomfortably large deficits and debt load.

If all this is approximately right, then the economy over Trump's four-year term will fall meaningfully short of what it would have if there had been no changes in policy. Eventually, it will suffer weaker GDP and job growth, higher inflation and interest rates, and a heavier government debt load.

Behind this poorer performance is a smaller workforce, as some undocumented workers leave and fewer legal immigrants come. Global trade also suffers, given the greater skepticism around our relationships and what is likely to be a somewhat stronger U.S. dollar, particularly against the Chinese yuan and other emerging currencies, like the Mexican peso.

There are important long-term economic benefits from lower marginal tax rates and a reformed corporate tax system, but these changes are too small to have a significant impact on growth, at least not quickly. And then there are the tax and spending policies that result in larger budget deficits. Expansionary fiscal policy makes sense when the economy is in a recession, but it makes little sense when the economy is operating near full employment, as it is today. It only fuels inflation, and higher interest rates.

Mr. Trump's election also arguably has a deeper, potentially more ominous meaning for the global economy. On the heels of the Brexit vote in the United Kingdom, it indicates that antiglobalization populist political sentiments are more widely held across the globe. Populism's next victim may be the eurozone. And if it fractures, so too will the global economic expansion.

Economic policy under President Trump can go in many different directions. But to believe that his anti-globalization, deficit-adding policies will result in a better economy is misguided.

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