ANALYSIS

The Trump Economy

Introduction

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The Trump Economy

BY MARK ZANDI AND CHRIS LAFAKIS

The election of Donald Trump as president of the United States has significant implications for the economy's outlook. Precisely what economic policies he will implement is highly uncertain, but it is likely there will be significant changes to tax law and government spending, trade and immigration policies, and regulation. Financial markets are already discounting these changes. This paper assesses the channels through which the Trump presidency will impact the economy and considers several policy scenarios and their economic consequences.

Under most scenarios, the economy will continue to perform well in the near term. It helps a lot that President Trump will inherit an economy that is fundamentally strong. Job creation remains robust, and the economy is near full employment. With a record number of open job positions and few layoffs, it would take a severe shock to derail the economy. But the economy under President Trump ultimately will be diminished. His anti-globalization and deficit-increasing policies will eventually catch up to the economy, and by the end of his term, recession odds will be uncomfortably high (see Chart 1).[1]

It is unlikely that President Trump will be fettered by Congress from making significant policy changes. The president has significant authority over trade and immigration policy and, while there is some legal debate, can make many decisions unilaterally.[2] Pulling out of past trade deals like NAFTA may be a stretch, but an aggressive president could do it and then take his chances in the courts, which would take years to sort out. A Republican-controlled House and Senate will also smooth the way for more policy becoming law, particularly since the Senate filibuster is no longer the legislative handcuff it used to be. The American people voted for change, and they are set to get it.

Tighter financial conditions

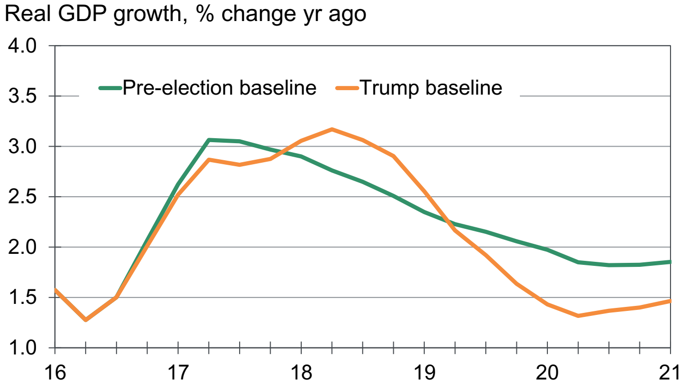
Financial markets are anticipating big changes, as they have reacted strongly to the Trump victory. Initially, stock prices fell sharply on the news. But they quickly rallied, and have since hit record highs. Long-term interest rates have jumped, with 10-year Treasury yields increasing by more than 50 basis points and 30-year yields rising even more. The U.S. dollar has also strengthened, up almost 5% on a real broad trade-weighted basis to levels last experienced in the early 2000s. Oil and other commodity prices have also firmed.

Investors appear to expect the Trump administration to adopt an expansionary fiscal policy: that is, deficit-financed tax cuts and increased government spending, most likely on infrastructure and the military. This shows up in a higher term premium on long-term bonds—the extra compensation bond investors require given the perceived risks such as bigger future budget deficits. With the economy near full employment, this has also lifted inflation expectations and prospects that the Federal Reserve will need to normalize interest rates more quickly than previously thought; markets put good odds on a December rate hike and two or three rate hikes next year. Given the outsize gains in financial and healthcare stocks, investors seem to expect President Trump to scale back Dodd-Frank regulatory reform and the Affordable Care Act, and even perhaps take a less aggressive anti-trust stance.

Considering the reaction across markets, financial conditions have tightened. That is, the market response will weigh on near-term economic growth, all else being equal. Higher stock prices are a plus for growth,

Chart 1: The Trump Economy

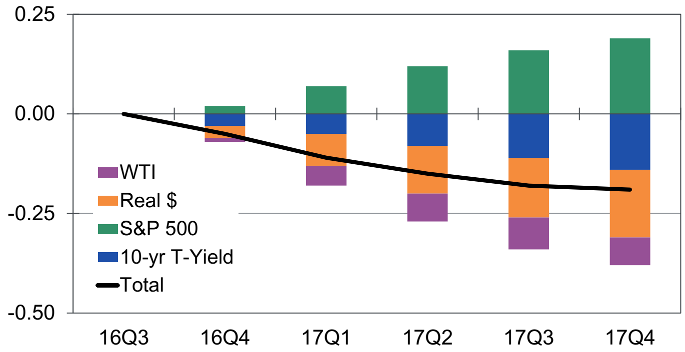
Real GDP growth, % change yr ago



Sources: BEA, Moody's Analytics

Chart 2: Financial Conditions Tighten

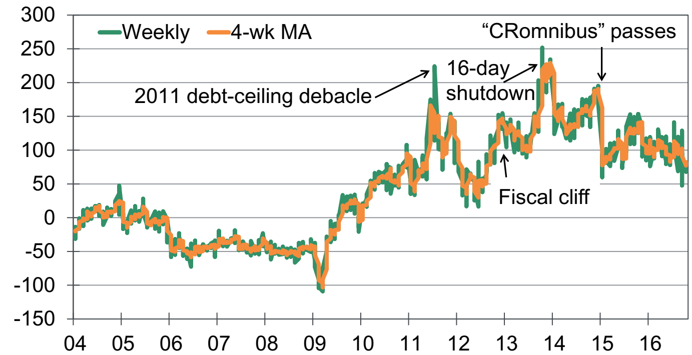
% chg in real GDP due to chg in financial conditions as of 11/23



Source: Moody's Analytics

Chart 3: Fiscal Policy Already Very Uncertain

Fiscal policy uncertainty, 2004-2005=0



Source: Moody's Analytics

but a stronger dollar and commodity prices and higher interest rates are negatives. This is already evident with the increase in fixed mortgage rates, which have quickly risen back over 4%. Refinancing has been significantly curtailed since the average coupon on outstanding mortgages is close to 4%. Home sales will likely soon feel it. Based on simulations of the Moody's Analytics model of the U.S. economy, the moves in financial markets since the election, if sustained, will soon ding economic growth (see Chart 2).

Policy uncertainty

Heightened policy uncertainty could also hurt near-term growth. Much depends on how quickly the Trump administration is able to articulate and implement its economic policies. The Trump campaign was not very forthcoming about those policies, likely in part because they were not well-developed. The campaign's economic policy team was notably thin, as nearly all establishment Republican economists decided not to participate.

This also makes the current transition process more difficult. It is 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. Undoubtedly they will come, but it could take an uncomfortably long time, particularly for impatient financial markets.

Policy uncertainty, which was already elevated before the election, acts as a pall over the economy (see Chart 3).[3] Businesses may delay investment and perhaps hiring decisions, and consumers will pause at least for a while to see how things are proceeding. A pullback in spending is unlikely, but businesses and consumers will be more cautious. This negative uncertainty effect was evident during the battles over the budget during much of the Obama administration, culminating in a government shutdown in late 2013. Although that will not happen now because the Congress is controlled by Republicans, lack of legislative progress could quickly become an economic problem.

Adding to the uncertainty is the potential disruption created by policies that Candidate Trump spoke of on the campaign trail. The most notable include his strongly voiced anti-globalization positions on trade and immigration. He has talked about renegotiating NAFTA and imposing tariffs on Chinese and Mexican imports. Thus, the yuan and the peso have weakened since the election. There are also his calls for a wall along the Mexican border and for requiring more than 11 million undocumented people, an estimated half of whom are Mexicans, to leave the country.

His massive tax and opaque spending policies also add to the uncertainty. The corporate and personal income tax cuts he proposed during the campaign would cost the Treasury an estimated $6.4 trillion over the next decade on a static basis—not accounting for the economic impact of those policies. His infrastructure plan is not well-defined, but he has said it will be three times what Hillary Clinton had proposed, or close to $1 trillion. He has also talked about significantly increasing veterans' benefits and military spending.

Whether and how the tax cuts and increased spending will be paid for is not clear. Candidate Trump often fell back on supply-side arguments that his policies would effectively double the economy's potential growth—from 2% per annum currently to 4%—thus generating enough tax revenue to pay for everything. The Republican Congress, whose focus before the election was on fiscal rectitude, may buy into this argument part way, but it is hard to see it fully buying in. This tension will be a source of uncertainty.

Obamacare, Dodd-Frank and environmental regulations will also surely be in the crosshairs of a Trump administration. It will be difficult to fundamentally change these reforms, at least quickly, as they have been largely implemented and it is unclear what would take their place. But it is hard to imagine there will not be some big changes. Uncertainty over regulation is never good for growth, regardless of whether one thinks it is a plus or minus for the economy.

Fiscal stimulus

Tighter financial conditions and heightened policy uncertainty will impede the economy early during the Trump administration, but this should give way to stronger growth once Trump's expected fiscal stimulus kicks in. Like the financial markets, we expect President Trump to implement an expansionary fiscal policy of deficit-financed tax cuts and greater government spending.

In our baseline—the most likely scenario post-election—the tax cuts will not be nearly as large as Trump proposed during the campaign, but the price tag still is expected to be sizable: close to $1 trillion over the next decade. Approximately two-thirds of the tax reductions are expected to come via changes to the personal income tax code, including across-the-board cuts in marginal rates, lower estate taxes, and the scaling back of taxes used to pay for Obamacare. The remaining one-third of the tax cuts will come from lower corporate income tax rates.

More government spending on veterans' benefits and the military is expected, and while more infrastructure spending is not as sure, given skepticism among some congressional Republicans around the costs, President-elect Trump is openly supportive of it. There have been suggestions by Trump's economic advisors to establish a public-private partnership, perhaps via a type of infrastructure bank, and the use of tax incentives to support measurably more development.[4] Presumably this would keep taxpayer costs down, but it would also slow the process and limit the type of infrastructure development that is possible.

There is also the sequester—the across-the-board spending cuts that were suspended as part of the 2013 budget deal. Unless lawmakers make a change, it is set to kick back in at the start of the 2018 fiscal year. Most likely, the sequester cuts to defense and mandatory entitlement programs will be suspended again or eliminated, but Republican policymakers will allow the cuts to most nondefense discretionary programs to take effect. Even so, government spending seems set to increase substantially compared with current law, by at least $500 billion over the next decade.

In the baseline, President Trump's tax and spending policies are assumed to be largely deficit-financed, and thus even on a dynamic basis—after accounting for the effects for the tax and spending policies on the economy—they will add more than $1.5 trillion to the government's cumulative budget deficits over the next decade. The nation's debt-to-GDP ratio will be some 3 percentage points higher by the end of Trump's term and almost 5 percentage points higher a decade from now.

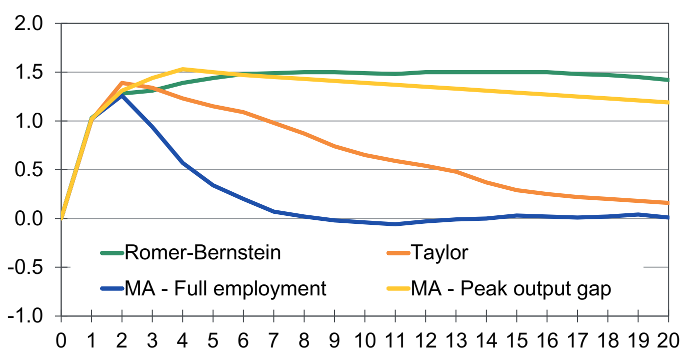
Economic growth should hit its apex in the first half of 2018, when the tax cutting and spending increases are in full swing. But even then, annualized real GDP growth never reaches 4%; certainly not for more than a quarter or two. Limiting the economic benefit of Trump's fiscal stimulus is the full-employment economy. The tax and spending multipliers—the growth due to the stimulus—are much smaller than they would be if the economy was struggling with very high unemployment, as it was in the Great Recession when the highly effective 2009 Recovery Act was implemented (see Chart 4).[5]

The expansionary fiscal policy is crowded out by a less accommodative Federal Reserve and global investors, so-called bond vigilantes, who push up long-term interest rates in anticipation of more inflation and bigger deficits. Higher inflation and interest rates are indeed part of our baseline scenario, with core consumer price inflation breaching 3% on a sustained basis, well above the Fed's inflation target. The Fed responds by increasing the federal funds rate to nearly 4% by early 2020, and the vigilantes push the 10-year Treasury yield to as high as 4.5%.

These are the classic symptoms of an overheating economy, which have historically ended in recession. There is no recession in our baseline, but the economy comes unnervingly close by the end of President Trump's term.

Chart 4: Alternative Multiplier Estimates

Federal government spending multiplier



Sources: BEA, Moody's Analytics

Globalization retreats

President Trump's ostensible disdain for international trade and foreign immigration also acts as a mounting weight on the economy during this term. The two trade deals currently in the works, the Trans-Pacific Partnership with the Pacific Rim, and the Transatlantic Trade and Investment Partnership with Europe will be shelved. The TPP in particular was politicized during the presidential campaign, and President-elect Trump has already said that killing the deal will be one of his first actions as president. Candidate Trump threatened to revisit NAFTA and even China's World Trade Organization status, but we chalk this up to campaign rhetoric and altering those agreements is probably a geopolitical bridge too far.

However, the Trump administration seems likely to go down a path other administrations have been loath to take, namely to label some countries as currency manipulators, including China, the U.S.'s largest source of imports. The penalty is assumed to be higher tariffs on most Chinese imports. Not the 45% hike Trump argued for during the campaign, but large enough that the average effective tariff on U.S. imports will meaningfully increase for the first time since the 1930s (see Chart 5).[6] No other country is expected to face across-the-board tariff hikes, but selective increases on certain products and even industries in some countries is possible.

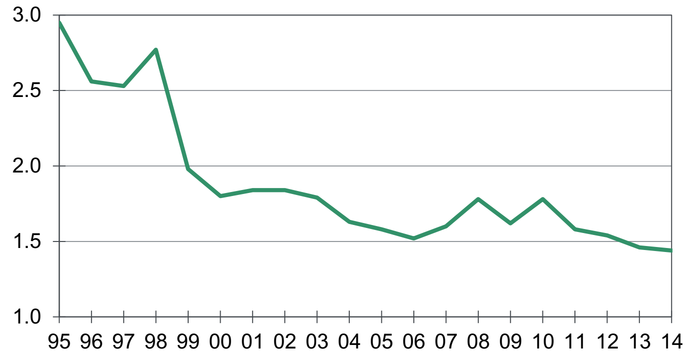
Although tensions are sure to rise with our trading partners, we assume in our baseline scenario that our partners *do not* retaliate with tariffs or restrictions on U.S.-made goods and services. We also assume that China *does not* allow its currency to freely float. If it did, the yuan would likely fall in value given the soft Chinese economy and the large capital outflows it is currently grappling with, further exacerbating the U.S. trade deficit.

Foreign immigration into the U.S. will also be significantly curtailed. This includes most refugees and immigrants from countries thought to be sources of terrorism, including several in the Middle East. To satisfy his campaign pledge to require the undocumented to leave the country, President Trump is expected to increase deportation enforcement and will more aggressively implement the e-verify program used by employers to determine whether potential employees have the appropriate work visas. It is unrealistic to expect that most of the 11 million undocumented would leave, but it is plausible that several million will have no choice. Also, given the prominence that U.S. border security took on during the campaign, it is hard to imagine the Trump administration not beefing up border enforcement and building something along the border with Mexico. In the baseline scenario, foreign immigration to the U.S. is expected to decline from about 1 million per annum to 700,000.

President Trump's anti-globalization stance leads to less international trade and fewer foreign immigrants. The long-running globalization process seemed already stalled in the wake of the Great Recession, and prospects are rising that globalization will soon be in retreat. Less trade and fewer immigrants mean a smaller economy, including fewer workers and consumers, and weaker long-run productivity and potential economic growth, because immigrants tend to be more entrepreneurial and risk-taking than domestic residents.[7]

Chart 5: Higher Tariffs Under President Trump?

U.S. avg effective tariff rate, %



Sources: World Bank, Moody's Analytics

Corporate tax reform

Partially offsetting the ill effects of the Trump administration's anti-globalization policies on long-term economic growth is the prospect for corporate tax reform. There has been bipartisan support for lowering marginal corporate tax rates, which are high by international standards, and eliminating the bad incentives U.S. multinationals face due to our worldwide tax system. The Obama administration has been a consistent proponent of corporate tax reform, but given the political logjams that have stymied its efforts, it has instead implemented a gerrymandered set of rules to forestall corporate inversions to avoid paying U.S. taxes.

We expect that President Trump will succeed in passing corporate tax reform. This is a priority for congressional Republicans, and there is no better time politically to get it done. The reform will include a lower marginal rate, although we expect the top marginal rate to decline from its current 35% to 25%, and not the 15% rate Trump proposed during the campaign. Fifteen percent would be too costly. The corporate tax code will also move toward more of a territorial system common in many other developed countries, and there will be a onetime lower tax rate for repatriation of foreign profits currently held overseas (see Table 1).[8]

Tax reform is not expected to include a "destination-basis cash flow tax," a favorite of some reform-minded House Republicans.[9] Such a tax change would reduce the tax rate for firms that are net exporters and increase the rate for net importers. It also has the potential for raising significant revenue to help pay for the lower marginal rate. However, the proposal may violate WTO export subsidy rules, and even with a substantial reduction in the tax rate, it is possible that some firms and industries could face a higher effective tax rate under this proposal than under current tax law. This is most likely for consumer-oriented industries such as apparel, consumer electronics and furniture, ensuring significant political roadblocks.

Reform will lower the cost of capital for businesses and prompt greater investment. The stock market rally post-election likely reflects this, at least in part. More investment and a larger capital stock will lift labor productivity growth and the economy's growth potential. This boost will need time to develop, much longer than Trump's term as president, and although it will be a meaningful addition to growth in the long run, it is not a game changer.

Trump Baseline

Summing it up, the economy in our new post-election Trump Baseline scenario, which in our judgment incorporates the most likely policy changes under President Trump, is

Table 1: Comparing Corporate Taxation

	Statutory tax rate on corporate income	Territorial or worldwide	Value-added tax
United States	**35.0%**	**Worldwide**	**7.3%**
Brazil	34.0%	Worldwide	17.0%
China	25.0%	Territorial	17.0%
France	34.4%	Territorial	20.0%
Germany	30.0%	Territorial	19.0%
India	42.0%	Worldwide	15.0%
Italy	27.5%	Territorial	22.0%
Korea	22.0%	Worldwide	10.0%
Mexico	30.0%	Worldwide	16.0%
Netherlands	25.0%	Territorial	21.0%
United Kingdom	20.0%	Territorial	20.0%

Note: VAT in U.S. is the average state and local sales tax rate.

Sources: Tax Foundation, Moody's Analytics more cyclical and ultimately falls short of the economy in our pre-election baseline, which was largely based on *no* change to fiscal policy (see Table 2).[10] Under the pre-election baseline, real GDP was expected to grow by 2.26% per annum during Trump's term (see Table 3).[11] Under the new baseline, growth is stronger during the first half of Trump's term, particularly in 2018, but weaker in the second half, especially in 2020. Over Trump's full four-year term, real GDP growth is a weaker 2.04% per annum.

The Trump baseline looks more like the classic business cycle. Expansionary fiscal policy is helpful when the economy is in a deep recession, like the financial crisis, but it is problematic when the economy is operating near full employment as it is today. It fuels inflation pressures and, in turn, a more restrictive monetary policy and higher long-term interest rates. The higher rates cool things off, invariably to the point that recession becomes a significant risk. Reinforcing this concern is the mounting weight on growth from Trump's anti-trade and immigration policies (see Chart 6).[12]

There may be some benefit in changing the current policy mix, which is characterized by easy money and a tight fiscal policy stance. Monetary policy remains hamstrung given that interest rates are close to the zero lower bound. The fiscal stimulus under the Trump baseline will allow the Fed to normalize rates more quickly, giving it more latitude to respond to the next recession when it does hit. Of course, the larger deficits used to finance the stimulus mean that lawmakers will have less fiscal space to use in responding to the next downturn.

Longer run, there are important economic benefits from lower marginal tax rates and the adoption of a territorial corporate tax system in the Trump baseline. But these are largely washed out by the anti-globalization policies, which lead to a smaller workforce as some undocumented workers leave the country and fewer legal immigrants come. Global trade also suffers given the greater skepticism around our trading relationships and what is likely to be a somewhat stronger U.S. dollar, impeding competition and

Table 2: Trump Baseline

	2016	2017	2018	2019	2020	2021	Avg annual growth 2016-2020
Real GDP (2009$ bil)	16,658.2	17,119.8	17,641.5	18,006.1	18,254.3	18,552.6	2.31
% change	*1.9*	*2.8*	*3.0*	*2.1*	*1.4*	*1.6*	
Employment (mil)	144.3	146.2	148.7	150.7	151.4	151.5	1.21
% change	*1.7*	*1.3*	*1.7*	*1.3*	*0.5*	*0.1*	
Unemployment rate (%)	4.9	4.9	4.6	4.5	4.8	5.3	
Real median household income (2009$)	51,661.3	51,878.1	52,240.4	52,549.7	52,814.4	53,178.0	0.55
% change	*1.9*	*0.4*	*0.7*	*0.6*	*0.5*	*0.7*	
Consumer prices (1980-82=100)	239.7	245.3	252.9	260.9	267.9	273.4	2.81
% change	*1.1*	*2.3*	*3.1*	*3.2*	*2.7*	*2.1*	
S&P 500 stock index	2,107.8	2,288.9	2,244.5	2,186.9	2,316.4	2,544.8	2.39
% change	*2.3*	*8.6*	*-1.9*	*-2.6*	*5.9*	*9.9*	
FHFA house price index	378.4	395.6	407.8	413.8	418.2	425.5	2.53
% change	*5.2*	*4.5*	*3.1*	*1.5*	*1.1*	*1.7*	
Federal funds rate (%)	0.4	1.0	1.9	3.4	3.7	3.4	
10-yr Treasury yield (%)	1.9	2.8	3.6	4.2	4.3	4.4	
Federal government debt ($ bil)	14,102.4	15,016.0	16,149.6	17,124.0	18,287.6	19,571.9	
Debt-to-GDP ratio (%)	76.0	77.2	78.4	79.2	81.5	84.4	
Federal budget deficit ($ bil)	-683.4	-801.1	-1,005.8	-1,140.8	-1,241.4	-1,304.1	
Deficit-to-GDP ratio (%)	-3.7	-4.1	-4.9	-5.3	-5.5	-5.6	
Government interest payments - federal ($ bil)	477.3	581.7	734.3	882.8	951.1	1003.7	
Interest-to-GDP ratio (%)	2.6	3.0	3.6	4.1	4.2	4.3	

Sources: BEA, BLS, S&P, FHFA, Treasury, Moody's Analytics

Table 3: Pre-Election Baseline

	2016	2017	2018	2019	2020	2021	Avg annual growth 2016-2020
Real GDP (2009$ bil)	16,660.5	17,148.1	17,611.6	17,998.3	18,334.3	18,691.4	2.42
% change	*1.9*	*2.9*	*2.7*	*2.2*	*1.9*	*1.9*	
Employment (mil)	144.3	146.4	148.5	150.5	152.0	152.6	1.30
% change	*1.7*	*1.5*	*1.4*	*1.4*	*1.0*	*0.4*	
Unemployment rate (%)	4.9	4.8	4.7	4.6	4.6	4.9	
Real median household income (2009$)	51,646.0	51,820.9	52,274.0	52,726.5	53,057.6	53,340.7	0.68
% change	*1.9*	*0.3*	*0.9*	*0.9*	*0.6*	*0.5*	
Consumer prices (1980-82=100)	239.8	245.7	252.4	259.3	265.9	272.2	2.61
% change	*1.2*	*2.5*	*2.7*	*2.8*	*2.5*	*2.4*	
S&P 500 stock index	2,091.5	2,204.5	2,200.4	2,192.7	2,378.1	2,609.6	3.26
% change	*1.5*	*5.4*	*-0.2*	*-0.3*	*8.5*	*9.7*	
FHFA house price index	378.5	397.3	410.1	415.0	420.8	430.1	2.68
% change	*5.2*	*5.0*	*3.2*	*1.2*	*1.4*	*2.2*	
Federal funds rate (%)	0.4	1.0	1.8	3.0	3.3	3.3	
10-yr Treasury yield (%)	1.8	2.5	3.5	3.9	3.8	4.0	
Federal government debt ($ bil)	14,102.3	15,000.4	16,014.2	16,813.3	17,768.4	18,816.8	
Debt-to-GDP ratio (%)	76.0	77.0	78.0	78.2	79.4	80.9	
Federal budget deficit ($ bil)	-682.7	-756.2	-870.5	-980.9	-1,045.2	-1,124.9	
Deficit-to-GDP ratio (%)	-3.7	-3.9	-4.2	-4.6	-4.7	-4.8	
Government interest payments - federal ($ bil)	477.1	579.8	727.7	864.1	919.3	963.2	
Interest-to-GDP ratio (%)	2.6	3.0	3.5	4.0	4.1	4.1	

Sources: BEA, BLS, S&P, FHFA, Treasury, Moody's Analytics

productivity growth. And then there are the tax and spending policies that result in larger pernicious budget deficits.

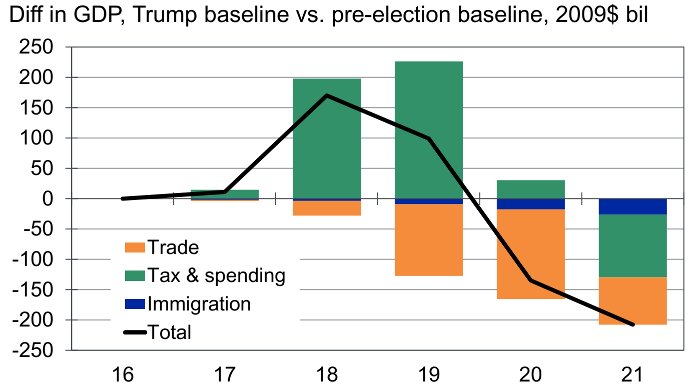
Trump Lite

The Trump baseline is one of many paths that policy and the economy can take under President Trump. Therefore, it is important to consider a range of scenarios regarding the policies that may ultimately be implemented. In the Trump Lite scenario, economic policy under President Trump is directionally the same as in the Trump baseline, but the assumed changes in policy are meaningfully smaller. The Republican Congress balks at the magnitude of the deficits created by the Trump administration's tax and spending plans and scales them back.

With regard to fiscal policy, this results in a tax and spending package that brings cumulative deficits of closer to $1 trillion over the next decade. This is composed of $750 billion in tax cuts and $250 billion in additional government spending. As in the Trump Baseline scenario, it is assumed in this scenario that there is corporate tax reform, including a 25% top marginal corporate tax rate, the adoption of a more territorial system, and

Chart 6: Trump Baseline Is More Cyclical

Diff in GDP, Trump baseline vs. pre-election baseline, 2009$ bil



Source: Moody's Analytics

lower tax rates on repatriated foreign earnings. Foreign immigration is curtailed in this scenario, but only to 900,000 per annum. China is labeled a currency manipulator, but the administration does *not* increase tariffs or other non-tariff trade barriers on imports from any of the trading partners.

Under the Trump Lite scenario, the economy's performance suffers only modestly compared with the prerecession baseline over the president's term. Real GDP, jobs, stock and house prices are all a bit lower by the next presidential inauguration in January 2021 (see Table 4). The most significant change is to the government's fiscal situation, as the nation's debt load is nearly 3 percentage points higher four years from now than it would have been with no policy changes.

Trump Unplugged

In Trump Unplugged, President Trump is able to convince Congress to pass economic policies that are closer in spirit and size to those he proposed during the campaign. The tax cuts in this scenario total $1.5 trillion over 10 years, composed of almost $1 trillion in personal tax cuts and $500 billion in corporate tax cuts. Corporate tax reform is similar to that in the other scenarios, although the top marginal rate is lowered further to 20%. Government spending increases by $750 billion over the next decade, mostly on infrastructure and the military.

The Trump administration is assumed to be tough on foreign immigration, reducing overall immigration to 600,000 persons per annum. And on trade, China is labeled a currency manipulator, and higher tariffs are placed on Chinese and Mexican imports, much as Trump proposed during the campaign. China and Mexico do not acquiesce and impose trade barriers on U.S. imports to their countries. China eventually allows its currency to float more freely, but it falls in value, making U.S. exports to the country even less competitive.

The U.S. and global economies suffer meaningfully in Trump Unplugged. Real GDP growth is stronger in 2017-2018 given the larger fiscal stimulus provided by the tax

Table 4: Trump Lite

	2016	2017	2018	2019	2020	2021	Avg annual growth 2016-2020
Real GDP (2009$ bil)	16,658.5	17,098.5	17,569.8	17,996.5	18,339.1	18,597.1	2.43
% change	*1.9*	*2.6*	*2.8*	*2.4*	*1.9*	*1.4*	
Employment (mil)	144.3	146.1	148.1	150.5	152.0	151.9	1.32
% change	*1.7*	*1.2*	*1.4*	*1.6*	*1.1*	*-0.1*	
Unemployment rate (%)	4.9	5.0	4.9	4.6	4.5	5.2	
Real median household income (2009$)	51,654.6	51,811.1	52,224.1	52,711.5	53,058.9	53,249.8	0.67
% change	*1.9*	*0.3*	*0.8*	*0.9*	*0.7*	*0.4*	
Consumer prices (1980-82=100)	239.8	245.6	252.5	259.5	266.0	272.3	2.63
% change	*1.2*	*2.4*	*2.8*	*2.8*	*2.5*	*2.4*	
S&P 500 stock index	2,103.1	2,242.9	2,227.6	2,187.3	2,333.2	2,552.8	2.63
% change	*2.0*	*6.6*	*-0.7*	*-1.8*	*6.7*	*9.4*	
FHFA house price index	378.5	395.8	407.4	412.2	417.7	427.2	2.50
% change	*5.2*	*4.6*	*2.9*	*1.2*	*1.3*	*2.3*	
Federal funds rate (%)	0.4	1.0	1.8	2.9	3.3	3.3	
10-yr Treasury yield (%)	1.9	2.8	3.6	4.1	4.1	4.2	
Federal government debt ($ bil)	14,102.2	15,028.7	16,189.7	17,152.2	18,219.2	19,346.8	
Debt-to-GDP Ratio (%)	76.0	77.3	79.0	79.8	81.4	83.5	
Federal budget deficit ($ bil)	-681.9	-829.9	-1,017.1	-1,102.8	-1,113.9	-1,216.8	
Deficit-to-GDP ratio (%)	-3.7	-4.3	-5.0	-5.1	-5.0	-5.3	
Government interest payments - federal ($ bil)	477.3	582.0	732.7	874.5	939.1	987.9	
Interest-to-GDP ratio (%)	2.6	3.0	3.6	4.1	4.2	4.3	

Sources: BEA, BLS, S&P, FHFA, Treasury, Moody's Analytics

Table 5: Trump Unplugged

	2016	2017	2018	2019	2020	2021	Avg annual growth 2016-2020
Real GDP (2009$ bil)	16,659.4	17,142.8	17,680.9	17,946.2	18,087.1	18,460.3	2.08
% change	*1.9*	*2.9*	*3.1*	*1.5*	*0.8*	*2.1*	
Employment (mil)	144.3	146.4	149.0	150.3	150.1	150.6	0.99
% change	*1.7*	*1.4*	*1.8*	*0.9*	*-0.1*	*0.3*	
Unemployment rate (%)	4.9	4.8	4.4	4.7	5.5	5.8	
Real median household income (2009$)	51,662.2	51,898.0	52,186.9	52,301.0	52,454.0	52,965.7	0.38
% change	*1.9*	*0.5*	*0.6*	*0.2*	*0.3*	*1.0*	
Consumer prices (1980-82=100)	239.7	245.3	253.5	262.6	269.8	274.9	3.00
% change	*1.1*	*2.3*	*3.3*	*3.6*	*2.7*	*1.9*	
S&P 500 stock index	2,107.8	2,289.7	2,251.0	2,178.1	2,284.0	2,539.9	2.03
% change	*2.3*	*8.6*	*-1.7*	*-3.2*	*4.9*	*11.2*	
FHFA house price index	378.4	395.6	408.7	415.2	417.8	422.7	2.51
% change	*5.2*	*4.5*	*3.3*	*1.6*	*0.6*	*1.2*	
Federal funds rate (%)	0.4	1.0	2.0	3.8	4.0	3.2	
10-yr Treasury yield (%)	1.9	2.8	3.7	4.4	4.6	4.6	
Federal government debt ($ bil)	14,102.3	15,010.1	16,145.1	17,205.4	18,536.1	19,997.0	
Debt-to-GDP ratio (%)	76.0	77.0	78.0	79.4	82.9	86.2	
Federal budget deficit ($ bil)	-682.9	-790.7	-1,035.6	-1,248.5	-1,404.8	-1,404.8	
Deficit-to-GDP ratio (%)	-3.7	-4.1	-5.0	-5.8	-6.3	-6.1	
Government interest payments - federal ($ bil)	477.3	582.0	736.5	891.3	963.8	1017.7	
Interest-to-GDP ratio (%)	2.6	3.0	3.6	4.1	4.3	4.4	

Sources: BEA, BLS, S&P, FHFA, Treasury, Moody's Analytics

cutting and spending hikes, but this causes the economy to overheat (see Table 5). Unemployment falls as low as 4%, fueling wage and price pressures. The Federal Reserve responds, pushing the federal funds rate up to 4% by early 2019. Ten-year Treasury yields peak just under 5%. The higher interest rates weigh on stock and house prices and ultimately on the broader economy. Growth stalls out in 2020, although the economy is able to skirt an outright recession. Over the length of the Trump presidency, real GDP growth is about 0.5% lower per annum.

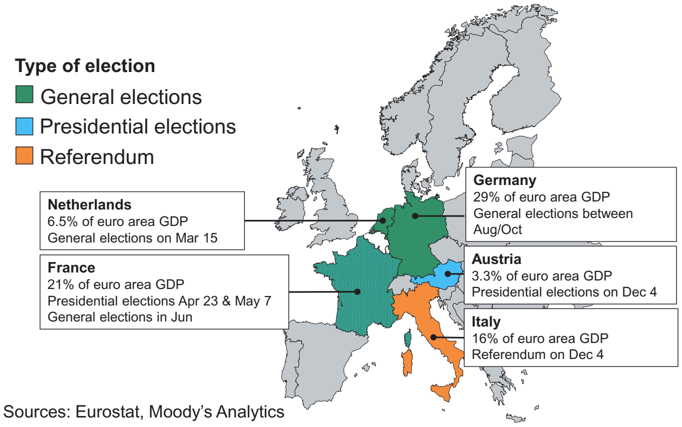
The nation's fiscal situation is also measurably worse. Candidate Trump often fell back on supply-side arguments that his policies would effectively double the economy's potential growth—from 2% per annum currently to 4%—and generate enough tax revenue to pay for everything. That does not happen. Although corporate tax reform and more infrastructure spending help to lift the supply side of the economy, these benefits accrue only over long periods of time and only if they are largely paid for on a static basis. The nation's debt-to-GDP ratio is approximately 5 percentage points higher by the end of President Trump's term than it would have been with no changes to policy.

Even more scenarios

Of course there are even more alternative paths that economic policy can take during the Trump presidency, some more optimistic and others significantly more pessimistic. On the optimistic side, the Trump administration may focus its energies more on corporate tax reform that is mostly paid for and on increased infrastructure spending. And his campaign's anti-globalization rhetoric could be forgotten, save for his decision to stop the TPP. If so, the economic outlook would be significantly brighter.

However, on the pessimistic side, we did not consider the implications of a Trump presidency on the political dynamics currently developing in Europe (see Chart 7). On the heels of the Brexit vote in the U.K., it indicates that anti-globalization populist political sentiment is more widely held across the globe. Populism's next victim may be the

Chart 7: Europe's Centrifugal Political Forces



Sources: Eurostat, Moody's Analytics

euro zone. Euroskeptic political parties have gained traction throughout Europe, and elections are fast approaching in most European countries. After Trump's victory, the odds are much higher that these previously fringe political parties will take power. If so, the euro zone itself will be threatened. If it fractures, the global economic expansion is threatened as well.

Needless to say, Moody's Analytics will continue to update our baseline and alternative scenarios as the Trump administration takes shape and its economic agenda becomes clearer.

Endnotes

1 Moody's Analytics conducted a study this past summer evaluating Candidate Trump's proposed economic policies. Taking these policies at face value, we concluded the economy would after a period of stronger growth early in his term, ultimately suffer a recession. We also showed that under more realistic assumptions regarding what policies would actually get through the legislative process and passed into law, growth would weaken, but not result in an outright recession.

2 The Peterson Institute provides a recent thorough analysis of presidents' legal authority with regard to trade policy.

3 The Moody's Analytics economic policy uncertainty index is based on equally weighted factors that measure both fiscal and monetary policy uncertainty. These include: 1) Percent of respondents to the Moody's Analytics weekly business survey that say regulation and legal issues are their biggest problem; 2) Five-year U.S. CDS-implied expected default frequencies or EDF; 3) The value of expiring tax provisions; 4) 10-year CPI dispersion from the Federal Reserve Bank of Philadelphia survey of professional forecasters; 5) Unemployment rate (one year ahead) forecast dispersion from the Philly Fed survey of professional forecasters; and 6) the Libor-OIS spread.

4 These proposals were made by economist Peter Navarro and financier Wilbur Ross, who has since been named as the Commerce Secretary in the Trump administration, in a Fox News op-ed.

5 In its analysis of the expected impacts of the American Reinvestment and Recovery Act in early 2009, the Obama administration estimated government spending multipliers that were persistently near 1.5—meaning that a $1 increase in government spending results in a $1.50 increase in GDP. In contrast, Professor John Taylor, a critic of fiscal stimulus, estimated that the multipliers were over 1 initially but quickly faded away. In the Moody's Analytics macro model, the multipliers vary considerably depending on the precise fiscal policy instrument and on how far the economy is from full employment. When the economy has a large output gap, that is, when actual GDP is far below potential GDP, as it was in early 2009, the multipliers are large and persistent. For example, the early-2009 multiplier for infrastructure spending in the Moody's model is very close to what the Obama administration assumed. However, as the output gap disappears, the multipliers diminish quickly. Indeed, when the output gap is zero—that is, when the economy is at full employment—the increase in government spending crowds out private sector output almost completely. The multipliers become quite small as the higher interest rates resulting from the increased government spending and larger budget deficits reduce consumer spending and business investment nearly dollar for dollar.

6 The U.S. has increased tariffs on China before, but only on selected goods such as steel.

7 The macroeconomic consequences of changes in foreign immigration policy is well-presented by the Congressional Budget Office in its assessment of the comprehensive 2013 immigration legislation that passed the Senate, but failed in the House.

8 The U.S. has a worldwide corporate tax system in which both domestic and foreign earnings are taxed. Most OECD countries have a territorial tax system in which they tax only activity that occurs within their borders. Multinationals headquartered in countries with a territorial system have a tax advantage over U.S. multinationals on their overseas operations, although this is mitigated somewhat as the U.S. also allows multinationals to defer taxes on most foreign profits until they are repatriated.

9 Alan Auerbach and the Tax Policy Center provide a good explainer of the destination-basis cash flow tax.

10 The pre-election baseline did assume that the sequester never takes effect. That is, the across-the-board spending cuts slated to take effect with the start of fiscal 2018 are repealed. This adds approximately $600 billion to cumulative budget deficits over the next decade, including the added interest expense.

11 This is the average annual growth during the period 2017Q1, when Trump is inaugurated, and 2021Q1, when the next inauguration occurs. This differs from the growth rate shown in the table, which is for the period 2016 to 2020.

12 The marginal macroeconomic impact of Trump's tax and spending, trade, and foreign immigration policies in the baseline scenario are available upon request.

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Moody's Analytics added the economic forecasting firm Economy.com to its portfolio in 2005. This unit is based in West Chester PA, a suburb of Philadelphia, with offices in London, Prague and Sydney. More information is available at www.economy.com.

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