PICTET 1805

# Policy Brief

## US elections: implications of Trump's win

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**Donald Trump's surprise win in the US presidential election has prompted a more restrained market reaction that might have been expected. We are cautious about the impact of a Trump presidency and are not changing our economic forecasts at this time—it is highly unclear how Trump will govern. Volatility spikes are likely to persist in the short term while this uncertainty remains.**

The Republicans have also held onto the Senate and the House, giving the US single-party government for the first time since 2010. This should ease the political gridlock that has obstructed effective policy-making in recent years.

***Policy outlook***

Distance between president and candidate Trump will be key

A Trump presidency could see major changes in policy on many themes such as fiscal policy, trade policy, immigration, the environment, financial regulation, healthcare, social security, and supervision of the Fed. However, it remains highly uncertain whether Trump will in fact pursue the policies he aired during the campaign.

**Fiscal policy.** On fiscal policy, Trump has made proposals that would boost government spending in general, and expenditure on infrastructure in particular—and he also placed stress in this during his acceptance speech. He has basically suggested financing infrastructure spending through government borrowing. Moreover, he envisages cutting the top corporate tax rate from 35% to 15% and the top individual tax rate from 39.6% to 33%. It is possible that we will see a meaningful fiscal stimulus, equivalent to 0.5 to 1.0 percentage points of GDP over 2017-18.

It remains to be seen whether Trump will pursue these policies, and whether Congress would accept them. Congress is probably more open to 'deficit spending' than it was, given that the federal deficit has fallen, from 9.8% of GDP in 2009 to 3.2% in 2016. But it is still far from certain that Congress will accept policies that raised the federal debt substantially.

**Trade policy.** Trump has promised a tougher stance on trade policy. He opposes the Trans-Pacific Partnership (TPP) and favours renegotiating the North American Free Trade Agreement (NAFTA). He has also promised to declare China a currency manipulator and called for high tariffs on goods sold by China or Mexico. There is clearly a risk of a marked increase in trade protectionism under Trump's presidency. However, president Trump could yet prove much more moderate than candidate Trump in this area—Trump stressed co-operation with other countries in his acceptance speech.

*Implications for the economy*

We are not changing our forecasts at this stage

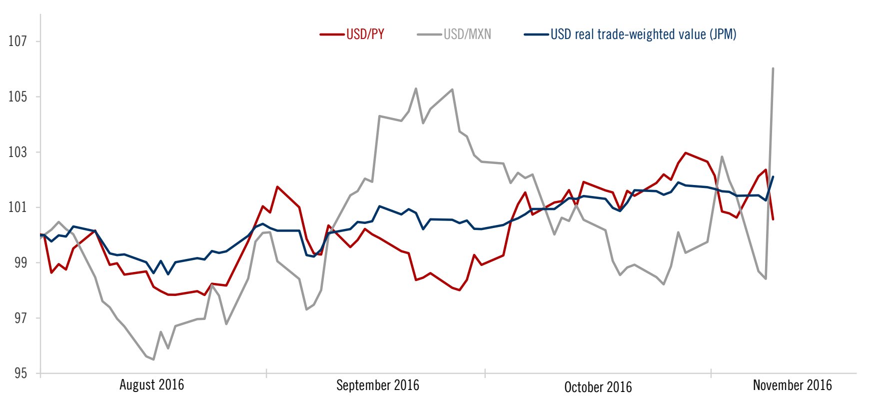
Our baseline economic forecast for the US is for US real GDP growth of 2.0% in 2017, up from a forecast 1.5% in 2016. We will not change this for the present, since Trump's policies remain highly uncertain and, even with a fiscal stimulus, any budgetary boost is unlikely to impact economic growth before the second half of 2017 at the earliest. In the short term, downside risks to the forecast have risen; but there are also upside risks to growth towards the end of 2017.

We continue to believe that core PCE inflation will only pick up modestly over the coming months. Our forecast that it will reach 1.9% y-o-y by year-end and 2.1% in December 2017 remain unchanged, although upside risks have risen.

Expectations for a Fed rate rise in December are now in question—much will depend on how long financial markets remain in turmoil and on how far any strengthening of the trade-weighted dollar tightens monetary conditions. However, our main scenario currently remains that the Fed will hike in December and twice more in 2017.

We are also not making any change to our global macroeconomic forecast. One risk is that strengthening of the yen, as a safe haven currency, could negatively impact Japan's growth.

**Chart: USD versus Mexican peso, Japanese yen and trade-weighted value**




*Source: Pictet WM - AA&MR, Datastream*

*Implications for markets*

We expect risk markets to continue to suffer from uncertainty in the short term—potentially a matter of several weeks—creating volatility spikes which will also affect the dollar. However, markets will then switch to the medium term outlook. If it becomes apparent that Trump and a Republican-led Congress herald a return to supply-side economics and, potentially, a major shift in fiscal policy, higher growth could provide a more supportive environment for equities and potentially the dollar in the medium term, but would be negative for bonds.

**The WMIC**