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Factoring in Trump 2.0

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Abstract

In view of the upcoming US presidential election in November 2024, the question of the economic impact of the new president - on the US and the world - is unsettling (financial) market participants. With the resignation of Joe Biden and the candidacy of Kamala Harris as the Democratic Party's presidential candidate, the cards have been reshuffled, but the prospects of Trump's return remain high. This should have not substantially changed after an energized and occasionally bitter presidential debate on September 10, 2024 and the subsequent Harris endorsement by music superstar Taylor Swift. Based on a possible reelection of Donald Trump, this note examines Trump's economic agenda and its effectiveness. It shows that the likelihood of economic catastrophe is low, with the biggest bottleneck being Trump's own unpredictability, which could lead to instability at home and abroad.

Zusammenfassung

Im Hinblick auf die anstehenden US-Präsidentschaftswahlen im November 2024 sind (Finanz-)Marktteilnehmer über die Frage nach den wirtschaftlichen Auswirkungen des neuen Präsidenten - auf die USA und die Welt - verunsichert. Mit dem Rücktritt von Joe Biden und der Kandidatur von Kamala Harris als Präsidentschaftskandidatin der Demokratischen Partei sind die Karten neu gemischt worden, aber die Aussichten auf eine Rückkehr Trumps bleiben hoch. Daran dürfte sich auch nach einer energiegeladenen und bisweilen erbitterten Präsidentschaftsdebatte am 10. September 2024 und der anschließenden Unterstützung von Harris durch den Musiksuperstar Taylor Swift nichts Wesentliches geändert haben. Ausgehend von einer möglichen Wiederwahl Donald Trumps wird in dieser Studie Trumps wirtschaftspolitische Agenda und deren Wirksamkeit untersucht. Sie zeigt, dass die Wahrscheinlichkeit einer wirtschaftlichen Katastrophe gering ist, wobei der größte Engpass in Trumps eigener Unberechenbarkeit liegt, die zu Instabilität im In- und Ausland führen könnte.

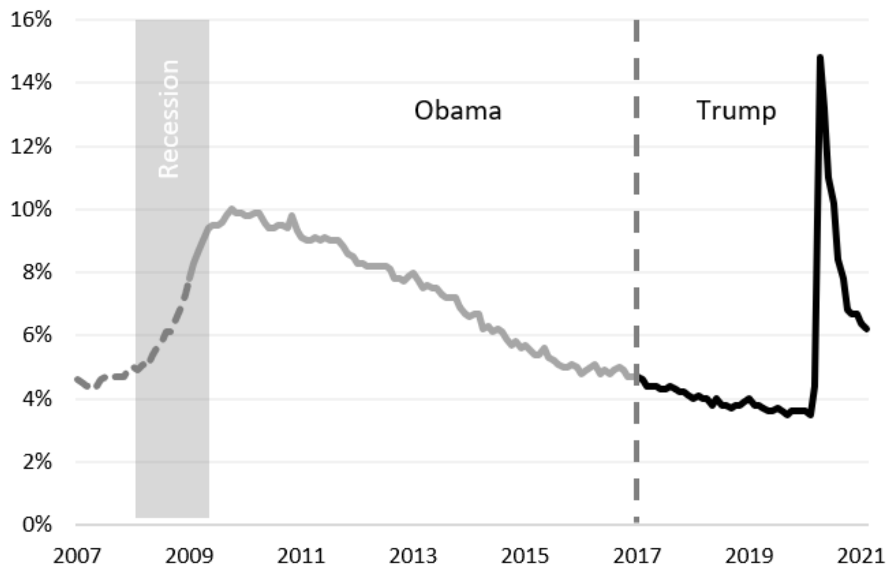
Trump 1.0 – a short account

By the time Donald Trump became president in January 2017, the economy had already recovered from the Great Recession.

During Trump's first presidency from January 2017 to January 2021, the US economy performed very well in terms of key macroeconomic indicators. Donald Trump attributed the strong economy to himself, claiming that he had inherited a "disaster" from President Barack Obama and had "accomplished an economic turnaround of historic proportions". But by the time he became president, the economy had already recovered from the Great Recession and had almost reached full strength.

Under Obama, the unemployment rate fell from a recession peak of 10% in October 2009 to 4.7% in January 2017, at the end of his second term. It has continued this positive trend under Trump and reached a 50-year low of 3.5% in September 2019 (**Fig. 1**). Employment growth was similarly positive. By the end of the Obama administration in January 2017, the economy had created jobs for 76 consecutive months. Under Trump, the streak was extended to 111 consecutive months. However, the average monthly job growth during Obama's second term was 215 thousand, while under Trump it was only 182 thousand until February 2019, i.e. excluding the coronavirus pandemic (**Fig. 2**).[1]

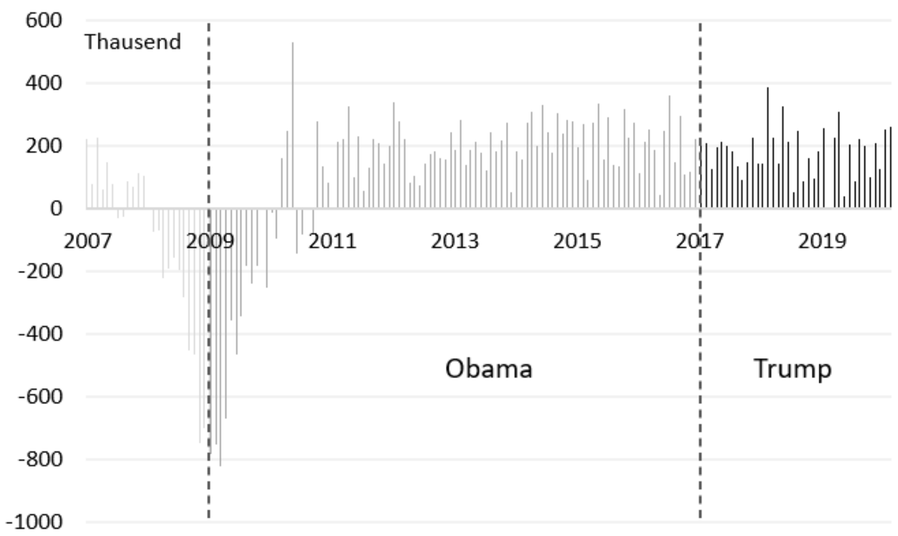
Figure 1. Unemployment rate in the US, Jan. 2007 to Jan. 2021



Source: Flossbach von Storch Research Institute based on Macrobond data

[1] The pandemic is excluded to allow for a more reasonable comparison.

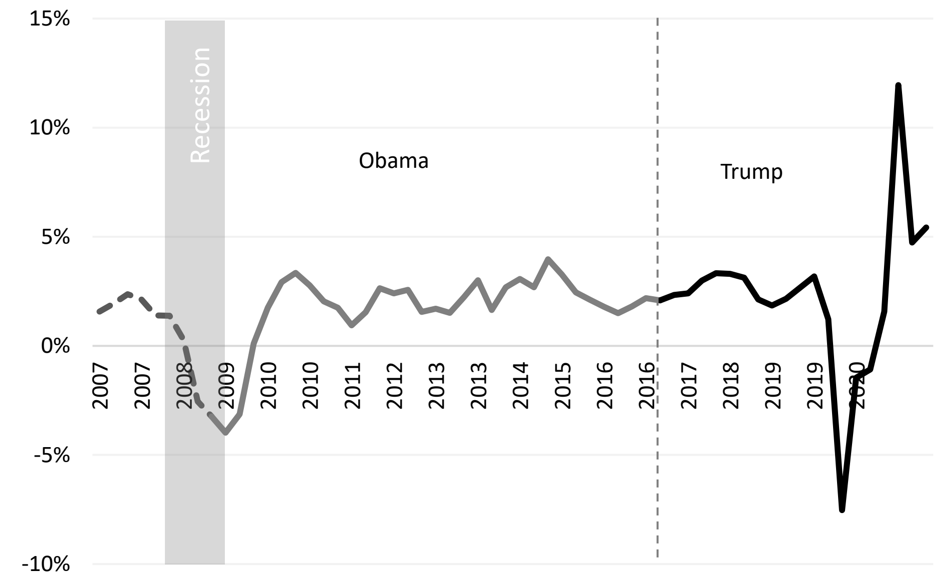
Figure 2. Job growth (mom change in non-farm payrolls) in the US, Jan. 2007 to Feb. 2020



Source: Flossbach von Storch Research Institute based on Macrobond data

No overperformance can be claimed for the growth of the US economy during Trump's first presidency. Average real GDP growth was 2.3% during the second Obama administration and 2.5% under Trump, again excluding the pandemic period (**Fig. 3**).

Figure 3. Growth of real GDP in the US (yoy), Q1 2007 to Q1 2021



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There is also no evidence in the economic literature that the booming economy is due to Trump. Based on a counterfactual scenario comparing the performance of the US economy to that of a "doppelganger" – an algorithm-based combination of other economies that most closely resemble the pre-election economic situation in the US – Born et al. (2021)[2] find little support for a Trump effect. After all, Trump's most notable economic policy – his tax cuts worth USD 1.9 trillion over ten years[3] – did not take effect until a year after he took office. By January 2018, the labor market had created 2.3 million new jobs and the unemployment rate had fallen from 4.7% to 4.1%.

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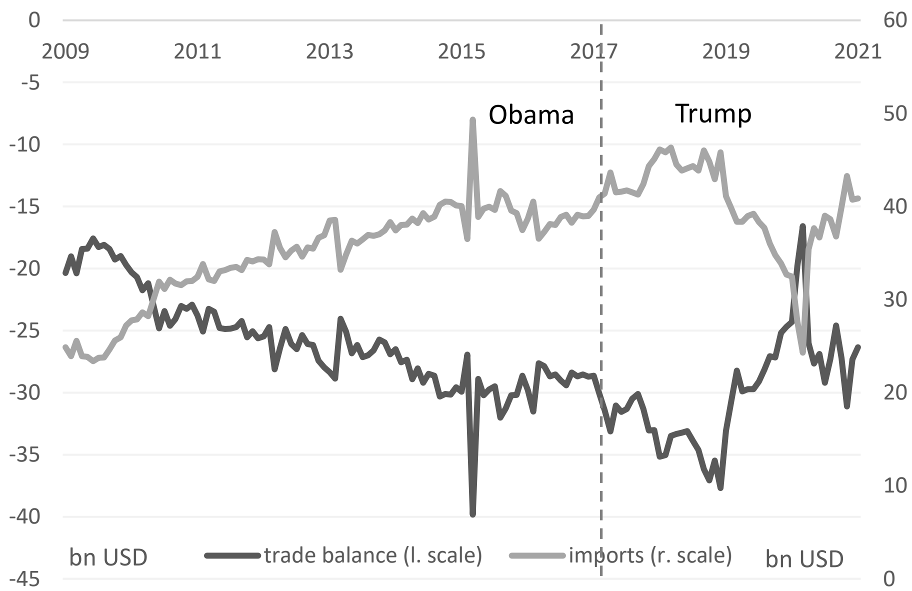
Likely the most visible stamp of Trump's presidency is the instigation of the trade war with China and the deterioration of public finances. Tariffs on Chinese goods had the primary goal to reduce the US trade deficit and save the US economy from the damage of "China's very abusive trade practices". The goal remained broadly uncompleted. The trade balance with China improved during the pandemic but started deteriorating thereafter, driven by rising imports from China (**Fig. 4**). Regarding public finances, increasing tariff revenues did not bring any visible relief since general government deficit expanded from 5.6% of GDP in Q1 2017 to 7.1% shortly before the pandemic. Accordingly, public debt increased from 102% of GDP to 109% over the same period (**Fig. 5**).

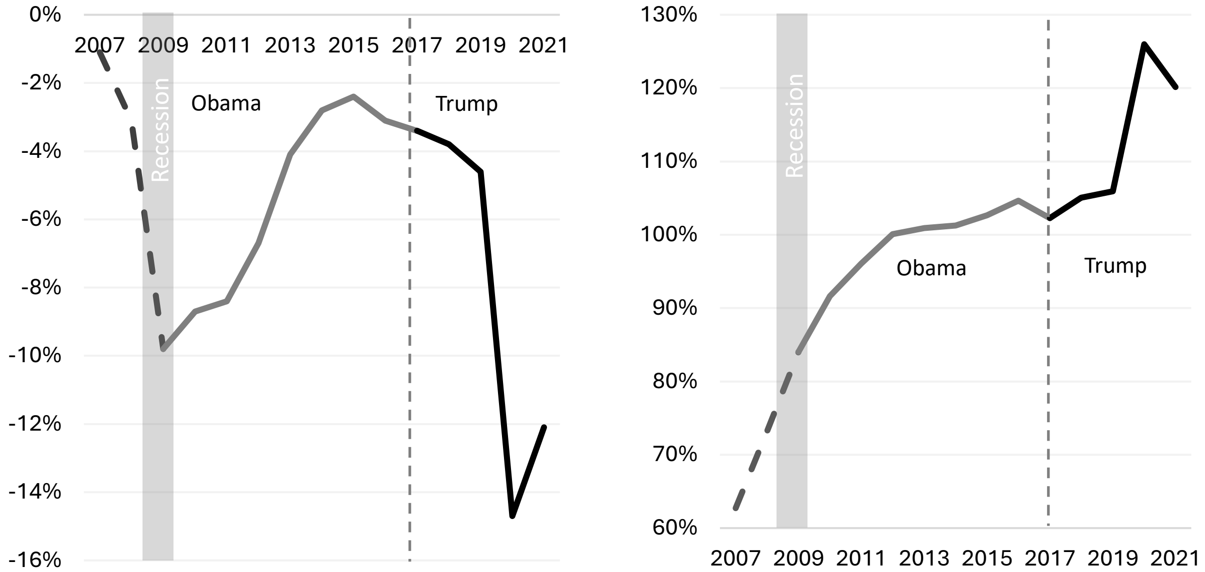
Figure 4. Trade balance with and imports from China, Jan. 2009 to Jan. 2021



Source: Flossbach von Storch Research Institute based on Macrobond data

[2] Born, B., Müller, G.J., Schularick, M., Sedláček, P. (2021). The macroeconomic impact of Trump. Policy Studies, 42(5-6), 580-591.
[3] Congressional Budget Office (2018). The Budget and Economic Outlook: 2018 to 2028. Available at: https://www.cbo.gov/publication/53651.

Figure 5. Balance of general government budget (left) and public debt (right), both as a percentage of GDP, 2007 to 2021



Source: Flossbach von Storch Research Institute based on Macrobond data

Trump's economic agenda 2.0

The selection of Senator Vance as the candidate for Vice President could have provided a little more clarity about the economic policy direction of a possible Trump administration. Vance is sometimes seen as belonging to the Republican wing, which favors the principles of the Reagan era – low taxes, low regulation and a free market economy.[4] This seems broadly in line with Donald Trump's current ideas, which are summarized in **Table 1**.

He has not yet released a detailed **tax plan** as part of his current bid for re-election, but he has unfolded some tax policy ideas. Among other – sometimes blurred ideas – he would seek to extend the expiring measures of the Tax Cuts and Jobs Act (TCJA) of 2017 and further reduce the corporate tax rate.[5] The latter would decrease from 21% to 20% in general and to 15% for companies that produce in the US.[6] Several provisions of the TCJA could have

[4] Vance's parents were actually Democrat voters but shifted to Republicans with Ronald Reagan (see Godement, F. (2024). United States presidential election: The import of J.D. Vance. Institut Montaigne). Some perceive him as "the Reagan of the Millennials (Dreher, R. (2024). J.D. Vance: The Reagan of the Millennials. The European Conservative). However, opinions to the contrary are also available (Klein, P. (2024). J.D. Vance pick represents another nail in coffin of Reagan Republicanism. National Review).
[5] The reduction in corporate taxes was permanent, but much of the rest of the TCJA law, including cuts to personal income taxes, are temporary and will expire at the end of 2025.
[6] The idea of a corporate tax reduction for domestically produced goods originates from Trump's speech at the Economic Club of New York on September 5, 2024. Additionally, the

some positive impact on the economy, most notably by incentivizing labor force participation (via low marginal tax rates and a simplified tax return) and supporting business activity and investment incentives (via the reformed business taxes). However, most of these growth effects were already achieved with the original reform. The marginal effect of the extension is therefore likely to be small. Should the extension of the TCJA boost the economy, this could lead to additional upward pressure on prices and would necessitate a restrictive monetary policy by the Fed. At the same time, budget deficits would persist, and public debt grow further as it is unlikely that Trump would be able to deliver sufficient budgetary offsets. This in turn poses the greatest risk to the underlying scenario. An extension of the TCJA without offsets could be blocked in Congress, which is likely to call for more fiscally responsible tax policies.

Table 1. Trump's core policies for a re-election

Trump 2.0	Main economic consequences	Hurdles
(Extension of 2017) tax cuts	Persisting budget deficits Rising public debt Growth impulse Inflationary pressure	Potential failure to gather bi-partisan agreement in Congress due to the lack of budgetary offsets
Changes to Fed's policy making	Rising budget deficits Inflationary pressure	Legal limits on alteration of Federal Reserve Board's composition
Curb on mass immigration	Worsening of shortages in labor supply Inflationary pressure	Overload of the responsible authorities Logistic and legal hurdles
Protectionism 2.0	Economic slowdown Short-term US dollar appreciation, long-term depreciation Inflationary pressure	No particular within the scope of presidential powers

Source: Based on Gehringer and Mayer (2024). Bühnennebel über der Wirtschaftspolitik von Trump und Harris. Flossbach von Storch Research Institute, Kommentar 27/08/2024

Trump has expressed his dissatisfaction with the **Fed** quite clearly, claiming that "it's sort of gotten it wrong a lot and [Powell] tending to be a little bit late on things. He gets a little bit too early and a little bit too late and, you know, that's very largely a gut feeling (…)".[7] Exactly how this would manifest itself is uncertain, but investors fear that he wants to influence the Fed's interest rate decisions. However, the president's powers in this regard are limited by law. The Federal Reserve is an independent authority to ensures that

expiring individual income tax and estate tax cuts from the TCJA would be made permanent. VP candidate Vance has also proposed increasing the child tax credit to 5,000 USD.

[7] Remarks during news conference at Mar-a-Lago, August 8, 2024.

monetary policy decisions are made on the basis of economic considerations rather than political influence. However, the president is authorized to appoint members to the seven-member Board of Governors of the Federal Reserve, including the chair and vice chair. Trump’s first chance to appoint a new governor will be in 2026, and he could also appoint a chair to replace Jerome Powell in January 2028. While the president can appoint individuals with certain economic policy views or preferences, governors' terms are staggered over 14 years, which should protect the Fed from short-term political pressure. In addition, these appointments must be confirmed by the Senate, which has blocked two of Trump's four nominees in the past.

Although the exact plans are still vague, Trump would continue his fight against **immigrants** in “the largest deportation operation in American history”.[8] But the feasibility of such plans is low. Not only logistical but also legal hurdles to rounding up and deporting undocumented immigrants are likely to thwart the plans. Deportations would keep the government busy for years, and Democrat states may refuse to cooperate. Finally, lengthy lawsuits against such plans and the overturning of deportation orders by courts are likely.

However, the idea of “mass deportation” was called into question for economic reasons. As a reaction to 9/11, immigration laws were more strictly enforced, leading to a restriction on the entry of undocumented immigrants and a relative increase in the entry of highly skilled immigrants. This type of immigration is less likely to steal jobs and is more inclined to become entrepreneurs and create new jobs. There is also evidence that (less skilled) immigrants are filling jobs vacated by the native population, which has a positive offsetting effect given the current labor shortage and inflationary pressures. Instead, the decline in the inflow of immigrants to the US since 2016 has coincided with a tightening of the US labor market.[9]

One policy area where Trump is particularly euphoric, but which has also gained the most notoriety, especially abroad, is his **trade policy** agenda. It includes a universal baseline import tariff of 10% and 60% specifically on imports from China - Trump's nemesis on this front. Aside from the expected negative impact on GDP – the higher, the more retaliation from affected trading partners – import tariffs could have an impact on the US dollar. In the short term, the currency is likely to appreciate as foreign goods become more

[8] This is number two on the list of promises on the official Republican Party platform “The American Presidency Project”, available at: https://www.presidency.ucsb.edu/documents/2024-republican-party-platform and on the official platform of Donald Trump. The pledge has been repeatedly used by Donald Trump in his electoral campaign speeches.
[9] See Cohen, E., and Shampine, S. (2022). Immigration shortfall may be a headwind for labor supply. Federal Reserve Bank of Kansas City, Economic Bulletin.

expensive and consumers and businesses would shift their demand more towards domestic goods. The intended reduction in the trade deficit – however uncertain this effect may be in light of past experience – could reduce the supply of US dollars on the foreign exchange markets and strengthen the external value of the currency. However, in the longer term and in the event of retaliatory measures or a full-blown trade war, US exports would be negatively impacted, which would reduce demand for the US dollar and weaken the currency. This effect would be exacerbated by additional inflationary pressure that could result from higher prices for imported and domestic goods. If this prompts the Fed to raise interest rates to combat inflation, it could have a negative impact on the economy and cause foreign investors to reduce their exposure to the US.

Trump's euphoria on the trade policy front is likely to ride the waves of powers he could use to implement his pledges. Although under normal circumstances the tariff imposition needs the approval in Congress, the president has some non-negligible powers under the trade laws. Under Section 232 of the Trade Expansion Act of 1962, national security emergency can be declared. The president can also invoke unfair trade practices under Section 301 of the Trade Act of 1974. Finally, he can claim injury to domestic industry under Section 201 of the same Trade Act. Straight from the beginning of his first presidency, Trump has not hesitated to circumvent Congress and used all three sections to introduce several significant tariff measures.[10]

Conclusions

As with many political programs, Trump's election promises offer some potential for both positive and negative economic stimulus. At the same time, legislation and regulations work out a powerful system of checks and balances which could play a moderating role in bringing about significant change. The effectiveness of policies under a potential Trump administration

[10] In January 2018, Trump imposed tariffs on imported solar panels and washing machines following a U.S. International Trade Commission (USITC) determination that a surge in imports was causing serious injury to domestic producers, invoking Section 201 of the Trade Act. In March 2018, Trump imposed tariffs of 25% on steel and 10% on aluminum imports, citing national security concerns according to Section 232 of the Trade Expansion Act. Starting in 2018, U.S. Trade Representative (USTR) determined unfair trade practices by China (Section 301 of the Trade Act), including intellectual property theft and forced technology transfers. The corresponding tariffs, ranging between 7.5% to 25% on various categories of goods, from electronics to clothing and machinery, were implemented in several phases, ultimately covering approximately 370 billion USD worth of imports from China.

could be increased provided the Republican majority is won in both the House of Representatives and Senate, which is nevertheless unlikely to happen.[11]

Most importantly, however, aside from his outspoken economic agenda, Donald Trump has often shown that he is capable of unorthodox policy moves and that his views are often erratic and mercurial, such as his encouragement of Russian attacks on "delinquent" NATO members and the claim to resolve the Russia-Ukraine conflict within 24 hours. This unpredictability could prove destabilizing and damaging to both the US economy and its relations with abroad. It has already led to non-negligible uncertainties in US relations with traditional allies such as Canada, the European Union and Japan. Looking ahead, an unpredictable Trump 2.0 could at best complicate bilateral relations with the US, and at worst require an entirely new approach.

[11] See Tofall N.F. (2024). The situation in the USA Part I: Checks and balances or deep state? To what extent could civil war-like conditions or fascism be imminent in the USA? Flossbach von Storch Research Institute, Comments 09.02.2024.

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