WHAT DOES ANOTHER TRUMP ADMINISTRATION MEAN FOR GLOBAL MARKETS?

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SUMMARY:

The 2024 election of Donald Trump as president marks a pivotal moment for the U.S. and global economies. Promising to revive the "America First" agenda, Trump's economic platform focuses on tax cuts, aggressive trade policies, deregulation, and stricter immigration controls. While these policies aim to stimulate domestic growth, protect U.S. industries, and reduce foreign dependencies, they also raise critical questions about fiscal sustainability, inflationary pressures, and their ripple effects on global markets. This analysis explores the key components of Trump's economic strategy, examining their short-term potential to boost consumer spending and investment while highlighting the medium- to long-term risks. From the impact of tariffs on trade and inflation to the challenges of reduced population growth and rising borrowing costs, the discussion aims to provide a comprehensive view of the policy trade-offs.

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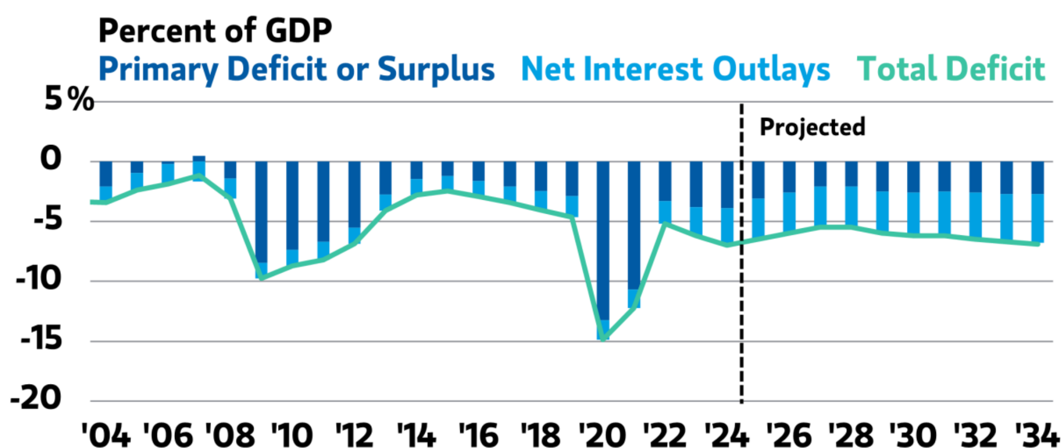
TRUMP ADMINISTRATION'S POLICY PLATFORM:

Tax cuts with a cost

The Trump administration's tax agenda builds on the 2017 Tax Cuts and Jobs Act (TCJA), aiming to make provisions like reduced individual, corporate, and capital gains tax rates permanent. Proposals include further reductions, such as lowering the corporate tax rate from 21% to 15% and reviving the 100% depreciation bonus to drive corporate investment. These measures, though growth-oriented, come with fiscal trade-offs. The success of these policies will heavily depend on Congressional approval, as tax legislation requires both House and Senate endorsement. While a Republican majority could ease passage, a divided Congress would pose significant hurdles. Negotiations could temper campaign promises, emphasizing fiscal responsibility amid rising deficits and geopolitical challenges.

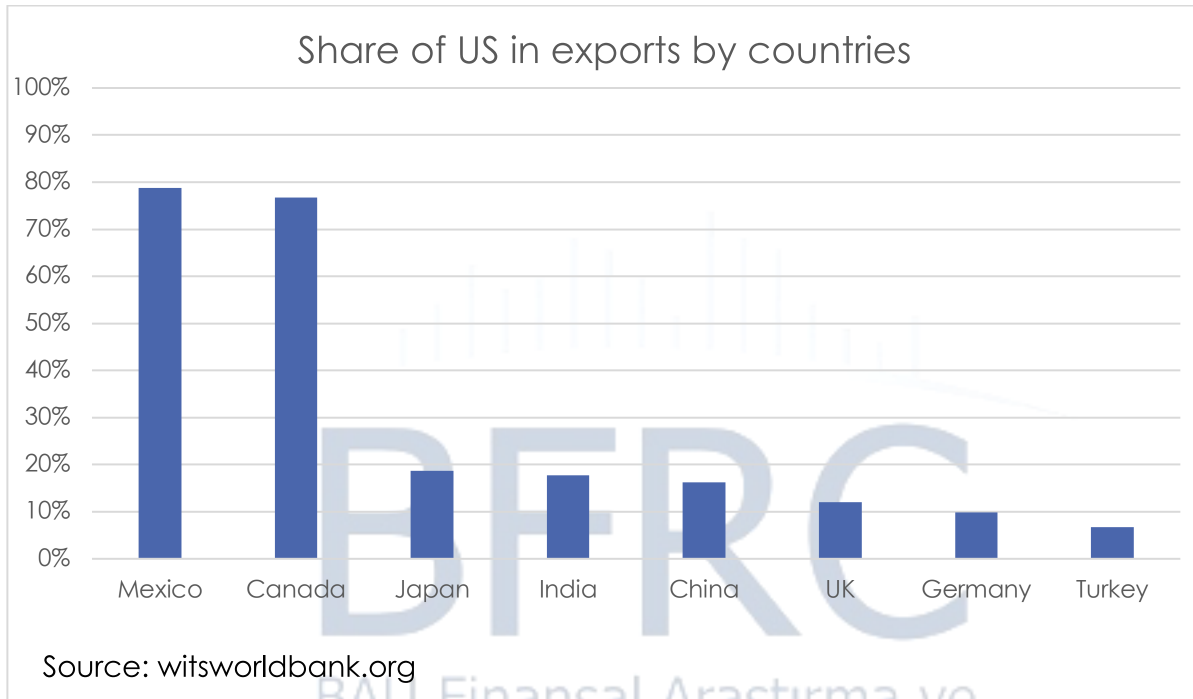


Source: Congressional Budget Office, Morgan Stanley Wealth Management Global Investment Office as of June 18, 2024

Projections from the Committee for a Responsible Federal Budget suggest these policies could add $7.75 trillion to the national debt over the next decade, with deficits potentially rising to 6.9% of GDP by 2034 (see graph). Net interest costs, currently 18% of tax revenue—the highest since the 1990s—could grow to 59% of the federal deficit, creating substantial fiscal pressures. To address federal spending, the administration proposes creating a "Department of Efficiency," led by Elon Musk, tasked with cutting $2 trillion in expenditures. This initiative focuses on reducing foreign aid, clean energy investments, and climate funding while protecting Social Security and Medicare from benefit cuts.

Protectionism and Tariff Wars 2

President Trump's proposed tariff policy signals a dramatic escalation in trade protectionism, with sweeping implications for the U.S. economy and its global partners. Central to this strategy is a 60% tariff on Chinese imports and a universal 10% levy on all foreign goods, designed to curb trade deficits and fund ambitious domestic reforms. According to the Tax Foundation, a 10% tariff could generate $2 trillion over the next decade, but this falls short of covering the costs of planned tax cuts and other reforms.



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The phased approach, starting with China, reflects a broader shift toward deglobalization as the administration seeks to reorient supply chains and reduce reliance on foreign production. These policies are likely to heighten tensions with the European Union, targeting key industries like automotive exports and pressing NATO allies to increase defense spending. While tariffs may disrupt EU supply chains and industrial output, they also risk fracturing global trade systems and pushing the EU to strengthen internal trade agreements and seek alternative markets.

Deregulation and a boost in energy, finance, and innovation

The Trump administration's deregulation agenda prioritizes expanding traditional energy production, easing industry constraints, and fostering innovation in emerging technologies. Trump plans to lift permitting pauses imposed by the Biden administration on oil and natural gas projects, accelerate approval timelines, and streamline processes.

While U.S. crude oil production is already at record levels, deregulation is expected to benefit producers by reducing operational barriers, even amid risks of oversupply suppressing prices. Natural gas producers, in particular, may gain from growing export demand, bolstered by relaxed regulatory hurdles.

Beyond energy, Trump's deregulation focus spans financial services, pharmaceuticals, and technology. Proposals to ease Basel III End Game requirements could reduce capital constraints for large-cap banks, potentially stimulating mergers and acquisitions. Pharmaceuticals and biotechnology stand to benefit from relaxed pricing controls and streamlined FDA approvals, promoting market growth and innovation. Emerging sectors like cryptocurrency, blockchain, and AI may see favorable treatment with reduced federal scrutiny, creating opportunities for expansion. Contrasting Biden's green-focused Inflation Reduction Act, Trump's "Drill, baby, drill" strategy highlights a shift toward traditional energy dominance, including large-scale drilling and a ban on offshore wind projects, signaling a retreat from net-zero leadership.

THE ECONOMIC CONSEQUENCES:

The Trump administration's economic policies present a mix of short-term optimism and long-term uncertainties, driven by lower taxes, tariffs, deregulation, and tighter immigration rules. In the near term, reduced taxes and a pro-business environment are expected to buoy consumer sentiment and risk appetite. High-income households, benefiting from rising asset prices and favorable interest rates, could drive consumer spending. Additionally, businesses may resume investment activity stalled by election uncertainties, further boosting economic activity.

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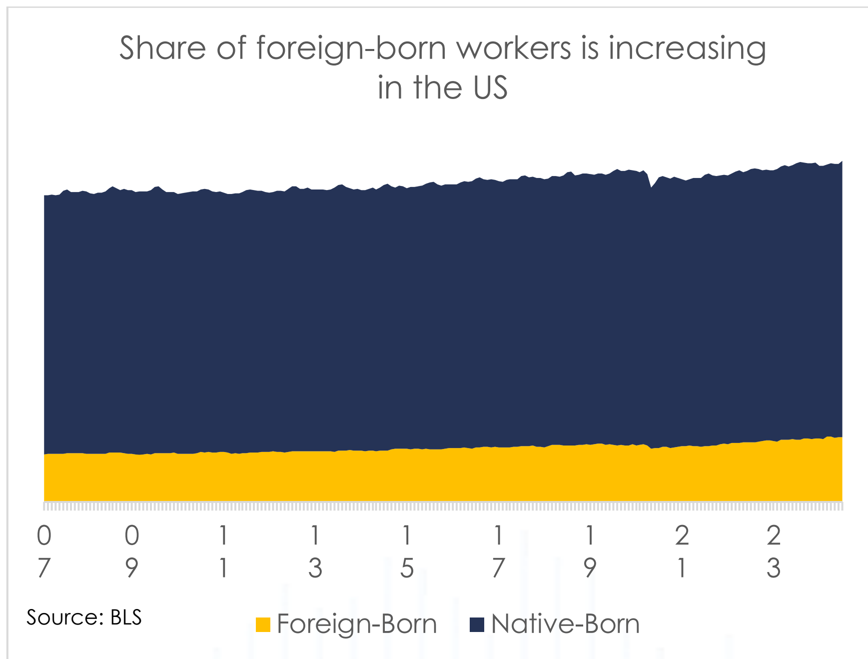
However, the medium- to long-term outlook is clouded by structural challenges. Immigration restrictions threaten labor supply in critical sectors like agriculture, where foreign-born workers make up 19.5% of the workforce. Reduced population growth could constrain productivity and increase wages, fueling inflation.



Trump’s proposed tariffs, including a 60% levy on Chinese imports and a universal 20% tariff on other goods, aim to protect domestic industries and generate revenue. However, these measures come with significant economic drawbacks. Tariffs function as taxes on U.S. importers, often passed on to consumers through higher prices. For example, in 2018, a 20% tariff on large residential washing machines led to a 12% price hike within months. Bloomberg Economics projects that the broader implementation of tariffs could increase inflation by 2.5% and reduce GDP by 0.5% within two years. Additionally, domestic manufacturers that rely on imported components face higher production costs, while supply chain disruptions could further strain retailers and erode consumer purchasing power.

The revenue-generating potential of tariffs is also limited when weighed against the broader economic fallout. While U.S. manufacturers may temporarily benefit from reduced competition, capacity constraints and retaliatory trade measures from partners like the EU and China could disrupt global trade flows.

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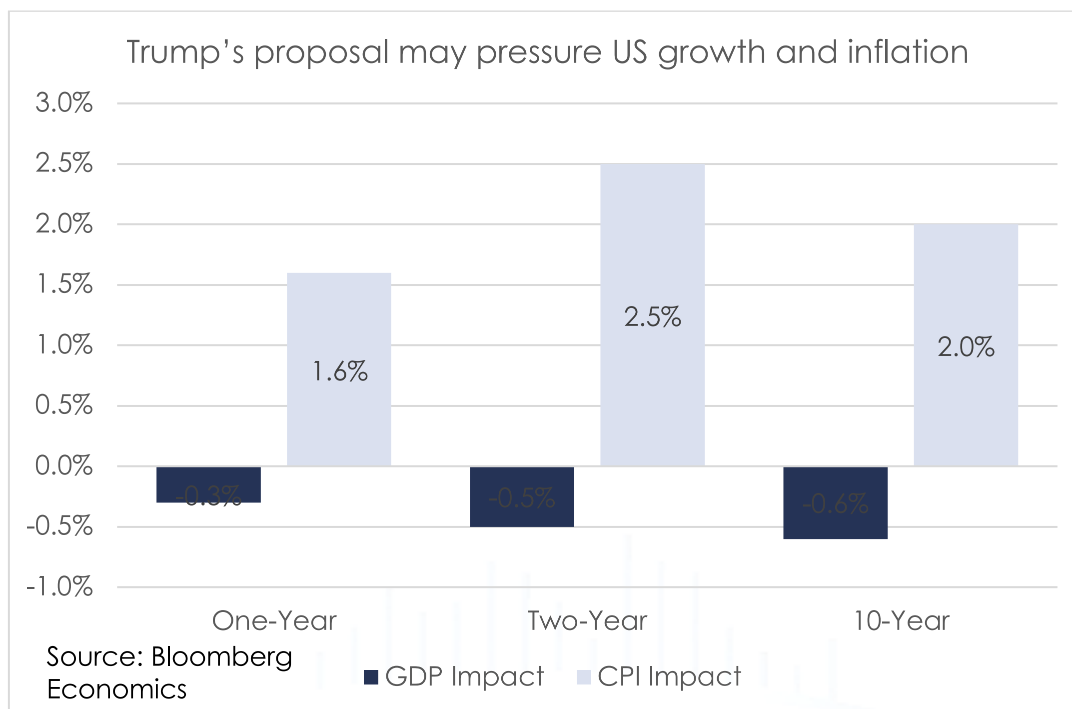

The IMF estimates that such protectionist policies could reduce global economic output by 0.8% in 2025 and 1.3% in 2026. This creates a challenging trade-off: higher tariffs may protect some domestic industries in the short term but risk slowing both U.S. and global economic growth in the medium term. The combination of aggressive tariff policies and expansive tax cuts amplifies long-term risks. Higher deficits are expected to drive up Treasury yields as the government borrows more, increasing borrowing costs for businesses and households. Fiscal sustainability concerns may lead investors to demand higher term premiums, further straining the economy. Treasury yields, which rose sharply following Trump's 2016 election, are likely to climb again, adding 20-40 basis points in the near term. Moreover, the Federal Reserve may tighten monetary policy to counter inflationary pressures, raising interest rates and steepening the yield curve.

This dynamic could reduce private investment and suppress GDP growth, especially as structural challenges such as declining labor force participation and productivity weigh on the economy.

Trump's policy mix of tax cuts, tariffs, and increased borrowing is expected to push U.S. borrowing costs higher, with Treasury yields projected to rise significantly. Following his 2024 victory, the 10-year Treasury yield is anticipated to increase by 20–40 basis points, driven by higher deficits and inflation expectations, though less dramatically than the 45 basis point surge in the 10 days after his 2016 win. Tariffs could further amplify inflationary pressures, steepening the yield curve over the next four years relative to the previous

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decade. The Federal Reserve may respond by tightening monetary policy, raising the neutral interest rate to counteract inflation and maintain its 2% target. This would suppress private investment and economic growth while increasing borrowing costs across the economy. However, with Jerome Powell's term as Fed Chair ending in 2026, Trump could nominate a more compliant chair aligned with his economic vision. This could include potential yield curve control measures to cap rising borrowing costs, but such actions may undermine the Fed's credibility, risking adverse market reactions and further uncertainty. European markets, by comparison, are expected to see a muted response, with German 10-year yields rising by about half the U.S. increase, widening the Treasury-Bund spread.

Trump's policies are likely to strain global markets, with Europe and emerging economies facing significant challenges. In Europe, proposed tariffs on exports, particularly automotive goods, could push Germany and the broader eurozone into recession, as the U.S. accounts for 20% of EU exports. Retaliatory trade measures and uncertainty around Trump's stance on NATO and Ukraine may further erode confidence, prompting the ECB to ease monetary policy, potentially cutting rates to 1.75% by 2025. Emerging markets, heavily reliant on trade and sensitive to U.S. dollar fluctuations, could face pressures from a stronger dollar, rising U.S. interest rates, and reduced global demand. China may attempt to limit yuan depreciation, while Central and Eastern European (CEE) currencies remain particularly vulnerable. The IMF estimates that Trump's trade protectionism could reduce global GDP by 0.8% in 2025 and 1.3% in 2026, underscoring the ripple effects of U.S. economic policies on international markets.

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CONCLUSION:

Trump's economic policies promise short-term growth but face long-term challenges

In conclusion, while the Trump administration's economic policy agenda may offer some short-term economic success through tax cuts, deregulation, and pro-business initiatives, its long-term sustainability faces significant challenges. Reduced population growth, heightened global trade protectionism, and rising borrowing costs are likely to constrain the U.S. economy's ability to generate sufficient tax revenues to offset the fiscal pressures of these policies. The aggressive pursuit of tariffs and stricter immigration measures, while politically appealing, could exacerbate structural labor shortages, inflate costs, and hinder productivity, further limiting growth potential. However, the historical disconnect between campaign promises and actual policy implementation leaves room for uncertainty. If Trump tempers his approach, the U.S. economy may avoid the more severe consequences of these plans. Ultimately, the trajectory of economic growth will hinge on the administration's ability to balance short-term gains with the realities of fiscal constraints and structural economic shifts over time.

NOTES:

1. *worldbank.org*
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3. *oec.world*
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