US Presidential Election: The Aftermath

AIB Treasury Economic Research Unit

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No panic as markets ponder surprise Trump victory

Donald Trump has caused a big surprise by capturing the White House. It has been a clean sweep for the Republican Party which has retained control of both Houses of Congress. This should make it easier for Mr Trump to implement his policies over the next couple of years. His victory speech was conciliatory in tone, in marked contrast to the Presidential campaign.

Mr Trump is an unknown quantity as he has not held political office before. His policies in areas like trade and immigration are controversial. He is very much seen as an 'outsider' and a populist politician who has promised to shake up the system. For these reasons, a Trump victory was always likely to trigger some uncertainty and volatility in markets, with **increased risk aversion and a flight-to-quality to safe-haven assets.** This was the initial reaction overnight, with the Japanese stock market down over 5%, bond yields falling, the dollar selling off, while safe-haven currencies such as the yen and Swiss franc rallied. Trading in US stock index futures was halted as they were down by over 4%.

Since then, markets have recovered, with the US stock index futures down by just over 1% this morning. Meanwhile, the dollar has recovered. Overnight, the euro rose from $1.10 to $1.13, but it has since fallen back to below $1.11. Similarly, the dollar has regained most of the ground lost overnight to sterling and the yen. Bond yields are now rising at the long-end of the curve in the US, with sharp jumps in ten and thirty year Treasury yields. Overall then, it has been **a surprisingly orderly market reaction to Trump's unexpected victory,** although there it **still scope for increased volatility** given the uncertainty about what a Trump presidency will bring.

Nonetheless, Mr Trump's fiscal policies are likely to be supportive of stock markets and the dollar and negative for bond markets. He is proposing sharp cuts in corporate and personal taxes and to expand public infrastructure spending. His plan to cut the top corporate tax rate from 35% to 15% is particularly eye-catching. This could see the repatriation of a lot of funds held off-shore by large US companies, providing a considerable income boost to the US economy—it could raise household income as a result of higher dividend payments - and see more corporate investment as well as greater share buy backs. It would also boost the US currency as all of these funds are unlikely to be held in dollar assets at present.

A key concern for markets relates to Trump's protectionist policies on trade. It is unlikely that the proposed trade deal between the US and EU will now not go ahead, while he may seek to renegotiate NATFA and the Trans-Pacific trade deals, as well as impose tariffs on imports from certain countries. The Republican Party, though, generally supports free trade and it may be that his proposals on trade and, indeed, immigration will be watered down and not have much of a negative impact on the economy.

Mr Trump's victory leaves the US Federal Reserve with a tricky policy conundrum. It was all set to raise rates at its next policy meeting in December. Markets, though, now see only a circa 60% chance of a rate hike in December given the uncertainty the Trump victory has created for financial markets and the economic outlook. Much will depend on how US stock markets perform in the next few weeks and whether Trump's win hits business and consumer confidence.

We still expect the Fed to raise rates next month. The Fed has shown a great reluctance to raise rates at times of uncertainty, but the current volatility in markets may have dissipated in a month's time. Mr Trump also believes that US rates have been kept too low for too long. His fiscal and trade policies are also inflationary and he is promising to ramp up US growth. Indeed, if his policies are implemented, they point to more Fed tightening than is being currently discounted by the markets. They look for the Fed funds rate to rise to around 1% by end 2018 from 0.375% at present, which looks too low if inflation rises.

Mr Trump's policies are likely to have only a limited impact on Ireland. His protectionist stance on free trade would suggest that US firms will continue to locate abroad to service global markets. Ireland remains a very attractive destination for US FDI, especially given the uncertainty created by Brexit for investment in the UK. However, Mr Trump may clamp down on company inversions, a practice that has seen some companies transfer balance sheet activities to Ireland, boosting the corporate tax take here. This recent spike in corporate tax receipts here could unwind if this practice is brought to an end.

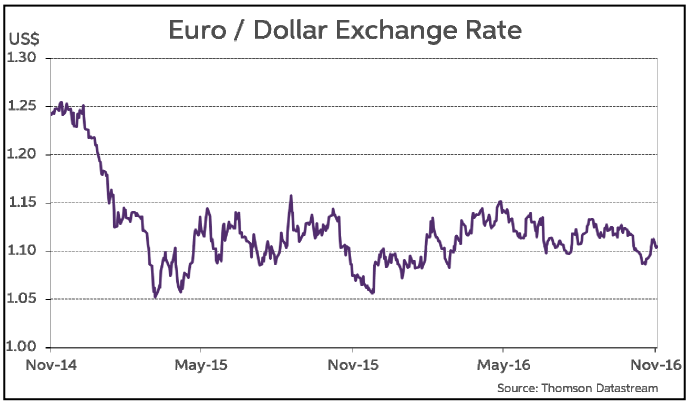
Oliver Mangan
Chief Economist
oliver.n.mangan@aib.ie

John Fahey
Senior Economist
john.j.fahey@aib.ie

Dara Turnbull
Economist
dara.c.turnbull@aib.ie

Strong protectionist bias but pro-growth

Donald Trump's policy platform, which is somewhat light on detail, falls very much into the category of anti-establishment populist policies, with a strong isolationist bias. This is most evident in his policies on trade and immigration.



His trade policies are 'protectionist' in design. He opposes the Trans-Pacific Partnership, a proposed trade agreement between the US and twelve Pacific Rim countries, including Japan, known as TPP. He also favours a renegotiation and/or potential withdrawal from existing trade agreements including NAFTA and the WTO. Given his strong opposition to the TTP deal, it is highly unlikely that under a Trump administration that the Transatlantic Trade and Investment Partnership (TTIP) with the EU will now not proceed. **Other trade policies involve the introduction of tariffs to protect American businesses**. These plans include the imposition of a 35% tariff on imports from Mexico and a 45% tariff on imports from China. He has also stated that he will declare China a currency manipulator.

In terms of fiscal policy, his proposals indicate a very expansionary stance. Analysis of his policies estimate that they would add $5.3tn to US national debt (currently at c.$20tn) over the next ten years. A Trump presidency favours tax cuts both for households and businesses. Current proposals suggest he would cut the top rate of income tax to 33% (from 39.6%), as well as reduce the number of tax brackets from 7 to 3 (12%, 25% and 33%).

During the campaign Mr Trump also outlined proposals for a reduction in the corporate tax rate. He stated his plan once in office is to reduce the rate from 35% to 15% while at the same time allowing companies to deduct the cost of investments from their taxable income. He has also referenced plans to deal with tax inversions, the practice whereby companies use cross border structures to reduce their tax liabilities in the US. In this regard, **he has said that under his presidency a one-off 10% tax on companies offshore cash will be imposed**.

The most controversial policies that Mr Trump has outlined are in relation to immigration. He has stated his desire for much stricter immigration controls, including a plan to deport 11m unauthorised immigrants.

Overall, while we have some broad outlines of what a Trump presidency will look like in terms of policies, many of his proposals are lacking in specifics. There is also the reality that Mr Trump has no prior experience of working in Washington, and the harsh realities of the political horse trading that is required to get things done on Capitol Hill could prove somewhat frustrating to him.

He will be helped to some extent by the fact that the Republican party has retained control of both the Senate and the House. However, given the strained relationship that exists between him and many in the Republican party hierarchy, he could still encounter difficulties in getting his desired policies through Congress.

Emerging economies are likely to be most worried by a Trump presidency given his opposition to free trade. The Mexican peso has fallen sharply and stock markets and currencies in other emerging economies will require close watching. Higher US interest rates and a strengthening dollar would not be welcomed by these economies either as they have large amounts of dollar debt to refinance.

Mr Trump's win should not have a major impact on other developed economies. The ECB is likely to be even more cautious about making any significant changes to its monetary policies in the near-term, with QE likely to be extended. Upward pressure on US yields, though, could see a steeping of curves elsewhere.

AIB Bankcentre, Ballsbridge, Dublin 4 Tel: 353-1-6600311 www.aibeconomics.com