Fiscal Outlook under a Trump Presidency

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Donald Trump staged the biggest presidential upset since 1948, when President Truman defeated Thomas Dewey. The election was a clean sweep for the Republicans. They will control the White House and both chambers of Congress. The combination of a Republican President and Republican Congress has produced above-average DJIA gains on a nominal basis and is the second-strongest combination on a real basis.

Of interest, after the 1948 election, the DJIA plunged -3.8%, the third-biggest post-election drop since at least 1900 after 1932 and 2008. But today the markets rallied. What is that telling us about the outlook for markets and the economy? Let's start with Monetary Policy.

Monetary Policy

Janet Yellen reappointed Fed chair in 2018

Trump has many reasons to keep Yellen and no reason to replace her. In terms of political "optics," Trump can ill-afford to dismiss the highest-ranking female official in the country. Also, however much they may gripe about monetary policy, financial market stakeholders tend to hate change and uncertainty even more. If he does not know now, Trump will soon be educated to appreciate that an "independent" Federal Reserve will insulate him from unpopular, if necessary, monetary policies.

Moreover, Trump's criticism of Yellen's ultra-low interest rate policies will be increasingly moot. As the FOMC has signaled, Yellen is virtually certain to hike rates by +25BP this December. (The fact that the President-elect has called for higher rates makes that an even easier decision). The latest "dot plot" shows at least two more rate hikes in 2017. Yellen will be moving in the direction that Trump says he wants.

Two hawkish nominees appointed to fill Fed Board of Governors/FOMC vacancies

Trump will fill the two vacant seats on the Fed Board of Governors. If his actions match his rhetoric, those nominees will tilt hawkish. Thus, the "dot plot" is probably the lower bound for actual rate hikes ahead.

Republicans did somewhat better than expected: they should hold 52 seats in the Senate (assuming a win in the Louisiana run-off next month) and at least 239 seats in the House, a comfortable 21-vote majority. Given these margins, and looking more closely at a Trump administration, there will likely be some changes ahead.

Philosophically, Trump is a "national greatness" conservative; he wants to incorporate some "big government" solutions into the usual GOP toolkit. Accordingly, Trump led his victory speech with a call for more "infrastructure" spending, a more concrete -- literally -- version of stimulus. Though it will take some doing, the GOP will accommodate him, in part.

Fiscal Policy

End to Sequester: increases in defense and some new 'infrastructure' spending.

The sequester, which has held down discretionary spending for the past five years, will be discarded.

The GOP has also been anxious to boost defense spending. House Speaker Paul Ryan, who we expect will retain the job, has said that such added spending was not in their program. However, the inclination in Congress is always to spend. Ryan will finesse the issue by demanding cuts in future discretionary spending, an end to various programs that have been on the GOP chopping block, unsuccessfully, since Reagan.

Thus, while the budget deficit will rise noticeably, the CBO's 10-year budget projection will show a more tolerable, if potentially fictional, scenario.

Senate Democrats will oppose even a promise of future cuts. Yet, by dangling road, transit and defense projects in some blue states, Trump and Senate Leader Mitch McConnell should find a filibuster-proof 60 votes. Especially since Democrats will be defending 25 Senate seats in the 2018 midterm vs. just eight Republicans.

In terms of real economic growth, this added government spending may well produce a modest tick up near-term. However, fiscal stimulus is a zero-sum game -- the need for higher future taxes to pay for it means that stimulus is only borrowing from the future.

Reforms to corporate taxes, no change to individual rates (maybe tinker with childcare).

For tax policy, both Clinton and Trump would have moved to reforming the inefficient corporate tax system. Otherwise, Trump's plan for individual tax rates is far too expensive to be enacted. There may be some tinkering with the child care tax credit, however.

There will be no action/reform on entitlements.

Trade Policy

On trade policy, the TransPacific Partnership treaty is pretty much dead (both Trump and, belatedly, Clinton opposed it). However, this does not mean a surge in protectionism. When GATT went off the rails two decades ago, succeeding U.S. administrations negotiated dozens of bilateral trade pacts which meaningfully reduced barriers. Trump, who campaigned on getting better trade deals, not ending them, will do the same. At the top of the list will be a post-Brexit free trade zone with the UK.

NAFTA will be left largely intact.

Regulatory Policy

On regulation, Trump will make needed fixes to Dodd-Frank financial rules. Trump's election means that energy and labor rules will also be relaxed some, i.e., more "drill, baby, drill" and less fretting over climate change, along with fewer restrictions on overtime, franchising, et al. In particular, the Consumer Financial Protection Bureau, an Elizabeth Warren brainchild, will be scaled back. It will lose its dubious extra-Constitutional status -- funding through the Fed with no Congressional oversight -- and be put into the Commerce Department budget.

Easing these regulations will help spur the economy; we see little downside.

Welfare Policy

Many economists have argued that Obama's welfare policies, particularly the explosion of means-tested benefits, have been a significant drag on the economy. Because those benefits decline as income rises, recipients work less. This has reduced economic growth by -0.5% or so. Trump and the GOP majority will reduce food stamps et al by tightening eligibility and increasing work requirements. By simply denying waivers to existing rules, Trump can accomplish this despite any Democratic opposition. This will spur the growth of the labor force and hours worked and boost the economy's overall potential.

However, Trump will add some benefits. One of his first actions will probably be the creation of a paid family and medical leave benefit. This is his daughter Ivanka's chosen cause, and he will not say no. In any case, the plan is clever. Using the unemployment insurance program to distribute the benefits will be relatively efficient. Since it is not means-tested, the effects on work incentives will be fairly modest.

Affordable Care Act

Finally, there is the Affordable Care Act, Obama's signature achievement. Trump pledged repeatedly to repeal Obamacare and "replace it with something better." The Republican Congress will demand nothing less. Many Trump voters, who were hit with double-digit ACA insurance premium increases in the week before the election, feel the same way.

Trump never spelled out his plan, and disentangling this beast that now affects one-sixth of the economy is a tall order. Significantly, Republicans have no intention of repealing the ACA tax hikes on "the rich," e.g., Paul Ryan's plan uses those revenues to help balance the budget. But several steps will likely be taken.

To start, ACA subsidies will remain in effect, at some level, at least for the near-term. The individual mandate/tax penalty will be discarded. While the (popular) rule that insurers must accept pre-existing conditions will be maintained, other mandated benefits will likely be reduced, thus lowering overall costs significantly.

We also expect an end to some restrictions on underwriting, in particular ending the mandated narrow spread based on age. The ACA now over-charges young people relative to their risks. Not surprisingly, many have chosen not to get this pricey insurance. Reforms to lower their costs would draw these young healthy people back into the insurance pool, thereby checking the "death spiral" of ever-increasing costs and premiums.

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