

## HOT TOPIC – Mature economies

November 4, 2016

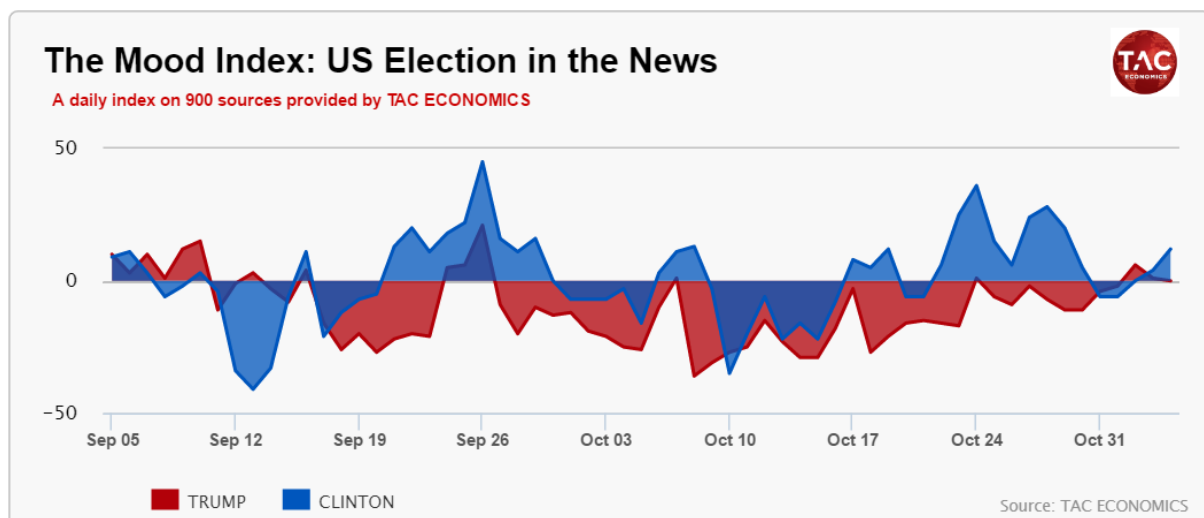


### US elections: what if?

#### Monitoring the media echo on the two Presidential candidates highlights the risks of a Trump election

Notwithstanding polls still suggesting a (short?) Clinton victory, global political winds and Donald Trump's strategy (getting the dissatisfied white citizen who does not vote usually to go to the polling station and cast his vote for him) may deliver the unexpected. Uncertainty a key item on any investor's mind and so until November 9 and the official results (assuming that no major legal challenge is made to published results). To help navigate the uncertainties and keep a permanent and updated view on the potential outcome, we provide here the results of our Mood Index<sup>1</sup> (exhibit 1) applied to both Hillary Clinton and Donald Trump. We make it available and updated every 4 hours on our website: <http://www.taceconomics.com/index.php?p=1&m=labs-use-elec&s=uselec>

Exhibit 1: TAC Mood Index – US Presidential Candidates in the news



The Buzz Index (available on the link above) shows how consistently more present was Trump until mid-October, before a short-term lull when Clinton became more present, and very identical levels over the last few days. More importantly, the Mood or Sentiment Index had shown a quasi-systemic negative value for Trump, and a more irregular (though clearly not systematically positive) value for Clinton. With the re-emergence of the FBI enquiry into Clinton's use of private servers for confidential information has not only erased the previous positive sentiment on Clinton but also removed Trump from negative territories. Bottom line: the outcome of the election remains highly uncertain and a Trump victory cannot be ruled out.

<sup>1</sup> The Mood Index is a way of looking at how Big Data can be used to monitor sentiment towards countries/topics through complex text mining and machine learning algorithms. TAC ECONOMICS' research team has automated the reading of more than 900 carefully selected news sources across the globe (Financial Times, Reuters, The Telegraph, central banks, international organizations, news feeds...), looks at them every 3 hours: our tool then computes a Buzz Index (the presence *intensity* in sources of information) and a Sentiment Index (results of sophisticated semantic analytical algorithms indicating if the news are *positive or negative*).

Many scenarios can emerge from the US election. It will mainly depend (1) on the results (tie results, contested victory, major legal challenge, etc) (2) on the Congressional elections. We will provide updated and more refined analyses on the impact on our global scenario once the results are known.

**If elected, Trump would be much more pragmatic than expected as many proposals are either unenforceable or unlikely to be voted by Congress.**

Probably more than other candidates (but not so different in essence), Trump’s promises and program are not going to be implemented. The Trump’s “campaigning” program is based mainly on an overhaul of the tax code and a reduction in taxes paid by individuals and corporations. Aggregate costs are estimated between USD 9.5 and 11.9 trillion from 2017 to 2026<sup>2</sup>, and should be associated with massive spending cuts (24% of total government spending without any target for fiscal balance). This cannot be implemented and will not, if only because of budget rules and the very low likelihood of a docile Congress.

On the domestic front, President Trump is therefore likely to be much more pragmatic than whatever his campaign’ speeches and promises include. Any “Trump scenario” will have to be a compromise. Here, a very interesting quantification exercise was conducted by our friends at Moody’s Analytics: they assessed the macroeconomic consequences of Trump’s proposed economic policies under different assumptions regarding the degree of compromise with Congress: the “more likely” outcome is a compromise scenario with USD1Tr tax cut (instead of USD9.5Tr) concentrated on lower / middle income, deficit neutrality, higher trade tariffs (only for 1year), 1/3 of undocumented workers deportations. Under such a compromise, the economic impact does not appear highly negative, as shown in the table below:

Exhibit 2: Consequences of Trump’s proposed economic policies under a compromise scenario

Variables	2017	2018	2019	2020	2026
Real GDP (%)	2.8	0.8	1.8	2.2	1.3
Unemployment rate (%)	4.8	5.7	5.9	5.4	6.0
FED Fund rate	2.0	4.0	2.9	1.8	2.7
10-yr Treasury yield (%)	3.6	4.0	4.0	4.0	4.2
Debt to GDP ratio (%)	76.6	78.3	80.0	80.0	90.5
Deficit to GDP ratio (%)	-4.1	-4.6	-4.3	-4.3	-5.3

Source: Moody’s

The US economy would accelerate in 2017 and avoid recession in 2018, and reach decent albeit weak cruising speed afterwards. Unemployment rate would rise very gradually as current undocumented workers leave the country, which creates significant shortage in specific sectors. Inflation would accelerate significantly given increased taxes on imported goods and upward pressures on wages. The Fed tightening cycle would be more pronounced and lead to higher bond yields, but here again not on a frightening scale (below 4.5% on 10yTNotes up to 2026). The

<sup>2</sup> Source: Tax Policy Center and Tax Foundations.

public debt and deficit ratios would rise, again in modest proportions. This is not a “rosy” or enthusiastic outlook for the US, but neither it is a doom and gloom scenario.

However, we do not consider the Trump election as a non-event. Just as in the case of Brexit, a Trump victory remains largely unexpected and under-assessed. In the short term, financial tensions will trigger large movements toward “safe assets” with increasing volatility, but this should prove temporary as or if domestic economic policy effects are not as negative as initially thought.

Our main concerns are risks related to international relations and related geopolitical issues and dangers. Added to the declared hostility vis-à-vis free trade agreements and a stronger willingness to engage in trade dispute, the fierce rhetoric against close US allies or critical uncertainties on future US engagement internationally have more power to trigger large, negative and unexpected developments than domestic policy implementation.

### **Whatever the US election result, common features of both candidates’ programs may prove more important than their differences**

Despite the key unknowns and whatever the winner of the election, a couple of critical “common grounds” have emerged from the campaign. We have identified at least three areas where both candidates are expected to act rapidly after being elected:

- Stronger support for “middle class America”, implying upward pressures on wages for working people (given the increase in minimum wages sought by both candidates);
- Hostility towards increasing international trade and further globalization for goods and services;
- Benign neglect for fiscal rectitude, both candidates supporting the idea that deficits will correct themselves once economic growth is assured.

The interesting conclusion is obviously that all three “common grounds” are conducive to higher inflation, though clearly with differing intensity according to each candidate’s program. A rapidly accelerating inflation rate in the US (by the way coupled to the end of deflation for producer prices in China and upward movement in inflation in Europe, not to mention the UK...) could be the trigger for major reversals in financial markets, either through bond markets considering that monetary policy is behind the curve and moving rapidly to positive real yields, or through equity markets losing the zero-cost liquidity support and probably seeing a further compression in corporate margins.

The election results may well provoke short-term financial instability, but the key issue is the inflation outlook in the US under any of the two candidates being elected President.