Interesting Times

US Economics

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Pre-Trump: Headwinds fading

- **Repeated tax increases & spending cuts**
- **..and ugly brinkmanship**
- **Pushed deficit down to 2.5% of GDP...**
- **..but 1% headwind to growth**
- **Fading of the strong dollar shock also**

Source: Hutchins Center on Fiscal and Monetary Policy at Brookings
Note: The “fiscal impact” is estimated by applying multipliers to changes in tax and spending policies
Pre-Trump: Hitting full employment

- **Hence, despite weak growth**
  - Have hit U-3 average
  - Will hit U-6 average by 1H 2017

- **Inflation 101**
  - A long lagging indicator
  - Once starts, hard to stop.

Source: Bureau of Labor Statistics
Pre-Trump: Reflation

Average hourly earnings
(% yoy, 3mo mavg)

Moving back to target
(%)
Pre-Trump: Fed forebearance

1. **Get economy to full employment**
   - *Plant foot on accelerator*
   - *Heal damaged sectors*

2. **Exit very slowly**
   - *Pause if trouble emerges*
   - *Focus on downside risks*
   - *Make certain wages and prices recover*

3. **Prepare for the next recession**
   - *Hope have enough ammunition*
   - *Hope other central banks can help*

Source: Bloomberg
Two Trumps

- **Near term growth-friendly Trump**
  - Deregulation
  - Big tax cuts
  - Big spending increases

- **Near term growth-unfriendly Trump**
  - Reverse free trade
  - Increase deportations
  - Replace Yellen with rules-based Chairman
  - Geo-political uncertainty

Source: BofA Merrill Lynch Global Research
Two tax plans

- **Corporate tax reform**
  - *Rate drops from 35% to 15% or 20%*
  - *Close loopholes*
  - *Border adjustment*
  - *Interest not deductible*

- **Personal tax reform**
  - *Three brackets: 12%, 25% and 33%*
  - *Ryan plan closes more loopholes*
  - *Eliminates estate tax*

Source: BofA Merrill Lynch Global Research, Tax Foundation
Infrastructure spending: A bridge too far

- **Big under-investment**
  - Low share of GDP aging fast
  - ASCE grade: “D+”
  - Both repair and big projects

- **Prospects**
  - Wide range of numbers...
  - ...but no specifics
  - House Republicans did not run on
  - Long implementation lags
  - Private-public partnership?

Source: BofA Merrill Lynch Global Research
Immigration policy: Increased enforcement

- **Smaller stuff**
  - *Increase deportations to 500,000*
  - *Small increase in enforcement budget*
  - *Enhance the fence*

- **Significant growth shock**
  - *11 million undocumented; 8 million working*
  - *5% of employment*
  - *10%-plus: farming, maintenance, restaurants, construction.*

Source: Pew Research Center, Department of Homeland Security
Trade policy

- **Border adjustment**
- **Mexico**
  - Deeply integrated supply chains
  - Jawboning impacts the margin
  - A tariff disrupts supply chains
- **China**
  - Numerous non-tariff barriers
  - Many WTO cases already
  - Aggressive opening gambit?

**Trade: Big flows, small gap ($bn saar)**

Source: BofA Merrill Lynch Global Research, Census Bureau
Baseline scenario: A little of everything

- **Growth stimulus**
  - Ryan-style tax reform
  - Small defense and infrastructure
  - Small boost from deregulation

- **Modest anti-globalization**
  - No tariff currency “wars”
  - Deportations of 500,000 per yr

- **Down-up growth pattern**
  - GDP: 2% in 2017, 2 ½% in 2018
  - Inflation and Fed creep higher

Source: BofA Merrill Lynch Global Research
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