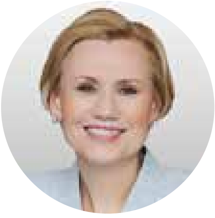
The four Trump policies most likely to impact economic growth

Weekly Market Compass | December 10, 2024



Kristina Hooper
Chief Global Market Strategist

Key takeaways

Potential growth opportunities

Deregulation and tax cuts could potentially provide a boost to US economic and market growth.

Potential growth challenges

Tariffs and immigration restrictions could have a negative impact, the severity of which depends on the details of their implementation.

The big picture

While we analyzed these four issues in a vacuum, we recognize that some policies will likely act as countervailing forces to other policies.

As the US heads toward a second Trump administration, the world is watching to see who will be part of the new administration and which campaign promises will come to fruition. We've both received many questions on this topic, and so in this short piece, we endeavor to cut through this noise and focus on the policies that could have the biggest impact on the economy and markets.

It's helpful to think about these issues in terms of a ledger: One column for policies likely to have a positive impact, and one column for policies likely to have a negative impact. It's important to note that the actual impact will depend on both the timing and scope of the policy. This is a complex and nuanced calculation; therefore, this is a rough estimate.

Potential growth opportunities: Deregulation and tax cuts

Deregulation

Businesses are more likely to invest when the political environment favors deregulation. The Trump administration's goal of removing 10 regulatory rules for each new regulatory rule is likely to create an environment of hyper deregulation. This is likely to be positive for economic growth.

For example, a study on regulation and investment found that the stricter regulation of markets in Europe relative to the US in the 1990s, during a period of rapid technological innovation, resulted in faster growth in the US than Europe.[1] The study found that regulatory reforms — in particular those that liberalize entry into markets — are likely to spur investment while tighter regulation of industry deters investment. In addition, an environment of deregulation could have a psychological impact, unleashing 'animal spirits' in not just the economy but markets. We may already be seeing evidence of those animal spirits in recent market moves.

- Timing: Traditional deregulation — the reduction of regulatory policies — especially, removal of "extra-regulatory" guidance can be implemented quickly because it doesn't require the approval of Congress. But the reversal of major regulations and elimination of entire government agencies would take more time; recommendations from the newly formed Department of Governmental Efficiency (DOGE) are not expected until mid-2026 and would then likely need Congressional approval to implement. However, eliminating agencies isn't necessary to achieving an environment of significant deregulation — it seems geared more toward cost reduction and a philosophical reduction in the size of government.
- Market impact: This is likely to encourage a 'risk on' environment for investing in general. Financial stocks and cryptocurrencies could especially benefit.

Tax cuts

The Trump administration will likely focus on extending and expanding the Tax Cuts and Jobs Act (TJCA) from Trump's first term. This would likely be positive for the economy, heading off a potential fiscal drag on growth if the TCJA were allowed to expire. It's important to note that some tax cuts are likely to have a more positive impact than others due to differences in their fiscal multipliers. (The fiscal multiplier measures the effect that increases in fiscal spending will have on a nation's economic output). For example, the Congressional Budget Office estimated the multiplier effect for two-year tax cuts for lower- and middle-income people ranges from 0.3 to 1.5, significantly more than the estimated multiplier effect of a one-year tax cut for higher-income people, which is estimated to be 0.1 to 0.6.[2]

The Trump platform also included plans to cut the top tax rate on corporate profits from 21% to 15% for domestic manufacturers, which would make the US one of the lowest corporate tax jurisdictions of any large wealthy country. However, we believe this proposal would be more difficult to achieve than extending the TCJA, given the latter's direct effect on voting households' budgets, the already large federal deficit, and pressures to raise spending on defense, for example. But even just a renewal of the TJCA would create an environment in which taxes are being reduced — and that, as with deregulation, could also unleash 'animal spirits' for the economy and markets.

We also have to factor in the impact that tax cuts will have on the fiscal deficit. The original TCJA was not fully funded (i.e., policymakers did not entirely offset the loss of tax revenue through spending cuts or other tax revenue). Therefore, it increased the fiscal deficit and added to overall government debt. As the Brookings Institution explains, "The financing of tax cuts significantly affects its impact on long-term growth. Tax cuts financed by immediate cuts in unproductive government spending could raise output, but tax cuts financed by reductions in government investment could reduce output. If they are not financed by spending cuts, tax cuts will lead to an increase in federal borrowing, which in turn, will reduce long-term growth."[3] However, Trump's economic advisers have argued that lower taxes (and deregulation) will spur investment, productivity and economic growth, eventually paying for the tax cuts indirectly. Time will tell which view is more correct, but tax-cut-related exuberance could continue to buoy US markets in the short term.

- Timing: Extending and expanding the TCJA would take more time to be implemented because it requires the approval of Congress, which historically acts close to a deadline, which in this case is December 31, 2025. We anticipate that the earliest this would go into effect is January 1, 2026.
- Market impact: This could unleash 'animal spirits' that encourage a 'risk on' environment for investing. Real estate investment trusts (REITs) could be a likely beneficiary. If the special 20% pass-through tax deduction from the TCJA is extended, REIT shareholders would be able to deduct 20% of taxable REIT dividend income they receive, not including dividends that qualify for the capital gains rates.

Potential growth challenges: Tariffs and immigration restrictions

Tariffs

President-elect Trump has promised to increase tariffs on Chinese goods to 60% or more and to implement a universal baseline tariff of 10% on goods from other countries. Scott Bessent, Trump's choice to lead the Treasury Department, has said that not only are tariffs a tool for raising revenue and protecting strategically important US industries, but he also called them a negotiating tool for achieving Trump's foreign policy objectives.

It's uncertain whether the tariffs are just threats or if they will actually be implemented — and for how long (which in turn would determine their economic impact).

In general, protectionist measures have tended to result in less optimal economic growth but have not necessarily served as a long-term hurdle for the stock market. We anticipate that these tariffs would be inflationary in the short term and, if maintained over the longer term, would likely dampen aggregate demand. In December 2018, during the US-China trade war, the Federal Reserve Beige Book noted that "Reports of tariff-induced cost increases have spread more broadly from manufacturers and contractors to retailers and restaurants." And tariff wars — or even just tariff threats — can create policy uncertainty that deters business investment. For example, the uncertainty caused by the 2018 trade war stalled US business investment.

- Timing: It seems that tariffs could be implemented in relative short order (~3 months) against China by invoking Section 301 of the Trade Act of 1974, which allows the US to impose trade sanctions on foreign countries that violate US trade agreements or engage in acts that are "unjustifiable" or "unreasonable," and/or invoking Section 232 of the Trade Expansion Act of 1962, which relates to the effects of specific industry imports on the national security of the United States. Universal tariffs for other imports might also be implemented by invoking Section 301, although some experts believe a 10% universal tariff would need to rely on the International Emergency Economic Powers Act of 1977 in order to be implemented quickly; otherwise the new Trump administration would need Congressional approval, which would take more time to come to fruition.

- Market impact: Tariffs applied during the first Trump administration led to stock market volatility and a negative return for the S&P 500 Index in 2018, although it didn't have a material impact over the longer term.[4] Chinese stocks were even more negatively impacted, posting double-digit losses in 2018, but were not affected over the longer term.[5] The tariff wars also led to a flight to quality globally, with the US dollar strengthening by 4.3% over the course of 2018.[6] Once a resolution was reached, the US economy and financial markets normalized.

Restrictive immigration policy

The incoming Trump administration's articulated immigration policy has two key components: securing and essentially closing the US's southern border, and deporting undocumented people already living in the United States.

- The threat to close the border is intended to spur action from Mexico to help end migration caravans and to disincentivize illegal crossings into the US. Any impact on industries that hire migrant labor may eventually be seen in US economic data.

- While Trump has said his administration will take action to deport the 15-20 million undocumented individuals within the United States, near-term actions may center on the roughly 1.4 million individuals that have been court-ordered to leave the US, as well as the backlog of 3.7 million immigration cases.[7] Mass deportations could prove very negative for economic growth — and they could also be inflationary, given that the US labor market is already very tight, with current unemployment at 4.2%.[8] Certain industries, primarily in the services sector, have been experiencing more acute labor shortages. And there could be a very substantial increase in pricing in some industries, such as agriculture, if laborers are deported. This could in turn reduce the economy's speed limit for growth and push up inflation, which could cause the US Federal Reserve (Fed) to pause — or even reverse — monetary policy easing.

A worst-case scenario would be mass deportations leading to a 'stagflationary' environment. In this scenario, a smaller labor force, or slower labor force growth, could reduce the economy's level of activity as well as its potential growth rate, likely causing a slowdown or recession, while also pushing up inflation through higher wage costs for businesses.

However, less aggressive deportation measures and/or a pivot to new immigration rules that would allow for legal temporary worker status once the border is deemed secure could mitigate the impacts of these policies.

- Timing: A border closing could be implemented quickly, and Congress is likely to provide the additional resources to support that effort. Neighboring countries would likely cooperate with the effort as a result of tariff threats. However, deportation could take far longer and would be extremely expensive. As a practical matter, it may also be difficult if not impossible to round up and deport many millions within the four years of the second Trump administration. It would perhaps require sizeable, long-running and expensive deployment of the National Guard and military on US soil — which would probably require the approval of many state governors as well as Congressional fiscal authorization and be subject to numerous court challenges. This may not come to fruition, at least not on at the scale promised by the incoming administration.
- Market impact: Closing the border could have a very modest impact on markets through possibly lower bond yields and somewhat reduced corporate and small-business profit margins. If deportations were to drive up inflation and, in turn, stall (or worse, reverse) Fed easing, that would likely reduce stock market returns. If deportation were to negatively impact growth and create a stagflationary environment, that would likely result in a significant stock market downturn.

Policies don't occur in a vacuum

In conclusion, we have to recognize that some Trump administration policies will likely act as countervailing forces to other Trump administration policies. And so, while we analyzed these four issues in a vacuum, the reality is that they could all be occurring simultaneously, resulting in different effects on the economy. In short, we're optimistic about the potential for some of Trump's key policies to positively impact economic growth and markets, but we're wary of policies that could negatively impact economic growth and markets. We will be following the situation closely and provide regular updates.

With contributions from Arnab Das

Notes

[1]Source: National Bureau of Economic Research Paper, "Regulation and Investment," Alesina, Ardagna, Nicoletti and Schiantarelli, 2003

[2]Source: Congressional Budget Office, 2015

[3]Source: The Brookings Institution, "Effects of Income Tax Changes on Economic Growth," Feb. 1, 2016

[4]Source: Bloomberg, L.P. The S&P 500 Index lost 4.4% in the one-year time period starting January 2018 but gained 17.6% in annualized returns in the three years starting January 2018.

[5]Source: MSCI. MSCI China Index lost 18.75% in calendar year 2018. However, it gained 23.66% in calendar year 2019 and 29.67% in calendar year 2020.

[6]Source: Bloomberg, L.P.

[7]Source of immigration data: Axios, "Trump's mass deportation plan could clog immigration courts for years," Nov. 24, 2024

[8]Source: US Bureau of Labor Statistics, Dec. 6, 2024

Important information

All investing involves risk, including the risk of loss.

Past performance does not guarantee future results.

Investments cannot be made directly in an index.

This does not constitute a recommendation of any investment strategy or product for a particular investor. Investors should consult a financial professional before making any investment decisions.

In general, stock values fluctuate, sometimes widely, in response to activities specific to the company as well as general market, economic and political conditions.

Investments in companies located or operating in Greater China are subject to the following risks: nationalization, expropriation, or confiscation of property, difficulty in obtaining and/or enforcing judgments, alteration or discontinuation of economic reforms, military conflicts, and China's dependency on the economies of other Asian countries, many of which are developing countries.

Cryptocurrencies are considered a highly speculative investment due to their lack of guaranteed value and limited track record. Cryptocurrency exchanges and cryptocurrency accounts are not backed or insured by any type of federal or government program or bank.

Cryptocurrencies are digital currencies that use cryptography for security and are not controlled by a central authority, such as a central bank.

Investments in real estate-related instruments may be affected by economic, legal, or environmental factors that affect property values, rents or occupancies of real estate. Real estate companies, including REITs or similar structures, tend to be small and mid-cap companies and their shares may be more volatile and less liquid.

The Summary of Commentary on Current Economic Conditions by Federal Reserve District (the Beige Book) is published eight times per year. Each Federal Reserve Bank gathers anecdotal information on current economic conditions in its district, and the Beige Book summarizes this information by district and sector.

The Congressional Budget Office (CBO) is a federal agency within the legislative branch of the United States government that provides budget and economic information to Congress.

Monetary easing refers to the lowering of interest rates and deposit ratios by central banks.

The Federal Reserve Beige Book is a summary of anecdotal information on current economic conditions in each of the Fed's 12 districts.

Inflation is the rate at which the general price level for goods and services is increasing.

The MSCI China Index captures large- and mid-cap representation across China H shares, B shares, Red chips, P chips, and foreign listings (e.g., ADRs).

The multiplier effect measures how much a change in fiscal policy affects income levels in the country due to the new policy's effect on spending, consumption, and investment levels in the economy.

Profit margin measures the profitability of a company by dividing net income by revenues.

Risk-on refers to price behavior driven by changes in investor risk tolerance; investors tend toward higher risk investments when they perceive risk as low.

The S&P 500® Index is an unmanaged index considered representative of the US stock market.

Spread represents the difference between two values or asset returns.

Stagflation is an economic condition marked by a combination of slow economic growth and rising prices.

The International Emergency Economic Powers Act of 1977 authorizes the president to regulate foreign economic transactions when the president declares a national emergency to deal with any unusual and extraordinary threat to the United States which has a foreign source.

The Consumer Price Index (CPI) measures change in consumer prices as determined by the US Bureau of Labor Statistics.

The New York Fed's Survey of Consumer Expectations is a nationally representative, Internet-based survey of a rotating panel of approximately 1,300 household heads.

The NFIB Small Business Optimism Index is produced on a quarterly basis by the National Federation of Independent Business to monitor how small-business owners' opinions about future business conditions.

The opinions referenced above are those of the author as of **Dec. 8, 2024.** These comments should not be construed as recommendations, but as an illustration of broader themes. Forward-looking statements are not guarantees of future results. They involve risks, uncertainties and assumptions; there can be no assurance that actual results will not differ materially from expectations.