Economic Research Unit

Economics Weekly

Bank of Ireland

Markets take benign view of Trump Presidency

Equity market gains and expectations the Fed will be more cautious in cutting official interest rates suggest that whilst investors expect fiscal stimulus and pro-growth deregulation from the new Trump administration, they are not, for now, pricing in a damaging global trade war. On that point, the Washington based Peterson Institute has estimated Trump's proposals for 20% tariffs on all imports and 60% on those from China would cost the average American family $2,600 via higher prices, a 4% hit to their real incomes, and for the poorest 20% of households a 6% hit. Nonetheless, given Trump may loosen fiscal policy via further tax cuts, markets now expect the Federal Reserve to cut rates to only just below 4% by end-2025 (vs sub 3% previously) helping the dollar appreciate on November 13th to $1.06 against the euro and $1.27 vis-a-vis sterling.

Equity markets see Trump as positive for growth: Since Donald Trump's election win on November 5th, the S&P 500 (3.8%), Dow Jones (4.6%) and Nasdaq (4.0%) have all seen significant gains, reflecting a view the new administration will be positive for the US economy. That said, there has been differentiation between sectors. Cyclicals such as US car producers and industrial firms outperformed in the wake of the election, but not so real estate, affected by expectations of higher interest rates. Similarly, German car manufacturers and French luxury goods names underperformed due to fears of tariffs. All-in-all, the equity market reaction suggests investors are not pricing-in, for now, a highly disruptive trade war between the US and its key trading partners.

Tariff proposals would be severe hit to US households' real incomes: A recent study by the Washington based Peterson Institute for International Economics, '*Why Trump's tariff proposals would harm working Americans*' found tariffs of 20% on all imports to the United States and 60% on those from China would cost the average family $2,600 per annum via higher prices, a 4.1% hit to their real incomes. Hence, tariffs would substantially push up US CPI inflation. The impact on the poorest 20% of US households would be even more severe, a 6.3% reduction in their real incomes. These results pose the question whether Trump's proposals are credible. A recent Peterson Institute blog post by Kimberly Clausing and Maurice Obstfeld found that Trump's assertion that tariff revenues could replace Federal taxes is '*simply put, impossible*'.

Fed now seen as more cautious on rates: President elect Trump has also proposed reducing the headline US corporate tax rate to 15% (from 21% currently) and a further package of household income tax cuts. However, the IMF are currently forecasting the US government deficit will equal $2.2trn, or 7.6% of nominal GDP in 2024, with the debt/GDP ratio rising to 121%. Although the dollar's reserve currency status can help the US sustain large fiscal, trade and current account deficits, the inevitable debate on the sustainability of the US federal deficit may curtail the ambition for tax cuts. Nonetheless, given expectations of looser fiscal policy investors now expect the Fed will have less room to cut interest rates. The US forward OIS curve now falls to 3.8% by end-2025, vs 2.9% only a couple of months ago.

Trump's win positive for the dollar: The dollar/euro exchange rate had peaked close to $1.12 in September, close to the strongest level for the euro in over two years. However, this week the dollar/euro exchange rate has fallen below $1.06, the weakest level for the euro since October 2023 (see chart below). Sterling has been a little more resilient, currently trading at 83.3p vis-a-vis the euro, one of the strongest levels for the euro/sterling exchange rate since the Brexit referendum in 2016. However, having traded as high as $1.34 against the dollar in September, the sterling exchange rate had fallen below $1.27 on November 13th, a 3-month low.

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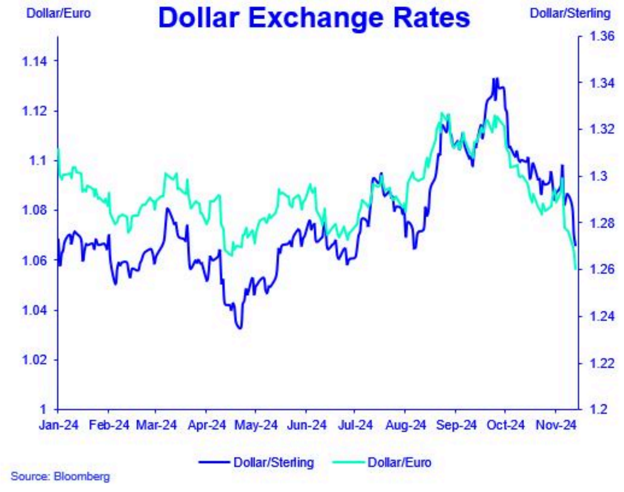

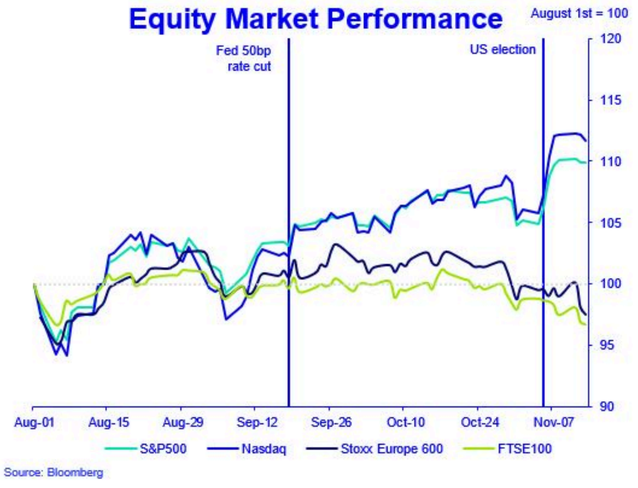

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