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Economic Research

Economic Briefing

Trump – winning bigly!

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Donald Trump will be the next US president. He can rely on Republican majorities in the Senate and presumably also in the House of Representatives. We explain what this means for the economic outlook.

Trump wins …

Donald Trump will move back into the White House after a four-year break. According to the assessment of the US media, he wins enough states to achieve a majority in the decisive electoral college.

… and can presumably count on Congress majorities

Trump can probably rely on a majority in both chambers of Congress. In the Senate, the Republicans can count on at least 51 of 100 seats. So far, they have been in the minority there. In the House of Representatives, the final result will not be known for a few days. As things stand now, the Republicans have won a net total of one seat in the House races that have already been decided. In a number of races, the winner has not yet been determined, so a Republican majority is not guaranteed. However, experience suggests that, in view of Trump's success, he is more likely to have pulled further Republicans along with him in the races that are still open. This should at least allow the Republicans to maintain their narrow majority in the House of Representatives, or even expand it slightly.

A majority in the Senate is particularly important for a smooth transition of power, as the relevant Senate committees must confirm the president's selection of personnel for cabinet posts and other high-level government offices.

Compared to 2020, the Trump team has prepared the takeover of government business much better. Numerous candidates for key posts have already been vetted.

According to media reports, the candidates for Secretary of the Treasury are investment bankers John Paulson and Howard Lutnick, hedge fund manager Scott Bessent, as well as a few people who were already active in Trump's first term in office such as Robert Lighthizer (then US Trade Representative), Jay Clayton (then Chairman of the US Securities and Exchange Commission), Larry Kudlow (then Director of the President's Economic Advisory Board) and Bill Hagerty (then US Ambassador to Japan).[1]

Jamieson Greer, who used to be Lighthizer's right-hand man, is being considered for the post of trade representative – an important office in view of Trump's tariff plans – alongside Lighthizer and Hagerty.

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What are his most important economic policy proposals?

The problem with estimating the economic impact of a Trump presidency is that he presented many and sometimes contradictory ideas during the election campaign. Much of it is certainly election bluster, and much of it is unlikely to survive contact with political reality unscathed. Moreover, some measures, particularly in the area of foreign trade, will provoke a backlash. It is almost impossible to reliably estimate what the net effect on growth and inflation will be. We have therefore selected some of the key policy areas and made assumptions about the scope and impact of the measures:

(a) Tariffs

The common thread running through Donald Trump's economic policy is his penchant for tariffs, which he regards as an economic panacea. He has discussed the possibility of a general tariff of at least 10% and a tariff rate of 60% on imports from China. If all of this were to be implemented, the US's average tariff rate would rise to its highest level since the 1930s.

During his first term in office, Trump already increased numerous tariffs, especially on goods traded with China. The authority to impose individual tariffs was based on relevant laws (the Trade Expansion Act of 1962 and the Trade Act of 1974). These require that unrestricted imports pose a clear risk to national security or that individual countries are clearly violating trade agreements.[2]

However, it is legally unclear whether the president also has the authority to introduce a general tariff. This is because, according to the Constitution, Congress has the *"Power To lay and collect Taxes, Duties, …To regulate Commerce with foreign Nations."* (Article 1, Section 8). According to prevailing opinion, Congress does not have the right to delegate such constitutional powers to someone else, such as the president.

The President would only be allowed to impose a general tariff in an emergency. A precedent for this is Nixon's temporary imposition of a 10% tariff in 1971. He invoked the existence of a balance of payments crisis; at that time, the US was still in the Bretton Woods fixed exchange rate system and was about to run out of gold to support the dollar.

We therefore expect Trump to only partially fulfill his threats, with China likely to be the main target. In addition, his aggressive demands are likely to be a negotiating tactic, and the US would probably agree to a compromise with some partners.

(b) Taxes

At the end of 2025, the income tax cuts that Trump passed during his first term in office will expire. Trump wants to extend them completely and has also promised a further reduction in the corporate tax rate (currently 21%), although the details of this are unclear.

Overall, the plans are expensive:

- The Committee for a Responsible Federal Budget (CRFB) estimates that extending the income tax cuts would increase the deficit by $5.4 trillion over 10 years.
- According to the CRFB, the further reduction in the corporate tax rate would cost between $150 billion and $600 billion. The wide range is explained by the fact that the details of this reduction are still completely unclear.
- Trump's promised tax exemption on pension payments would increase the deficit by a further $1.3 trillion.

All of the tax plans would increase the deficit by between $6.8 trillion and $15.7 trillion over the next ten years, with a central estimate of $10 trillion. The Penn-Wharton budget model comes up with a shortfall of $5.8 trillion over ten years, but this does not take into account some of Trump's less clear plans.

As for how to finance this, Trump points to the extensive revenues he expects from increased tariffs. However, the CRFB arrives at revenues of between 2 trillion and 4 trillion dollars at best. “Dynamic” effects, i.e. additional tax revenues from the assumed growth-promoting effects of Trump's measures, are likely to be quite low (see the estimate of the impact on growth below).

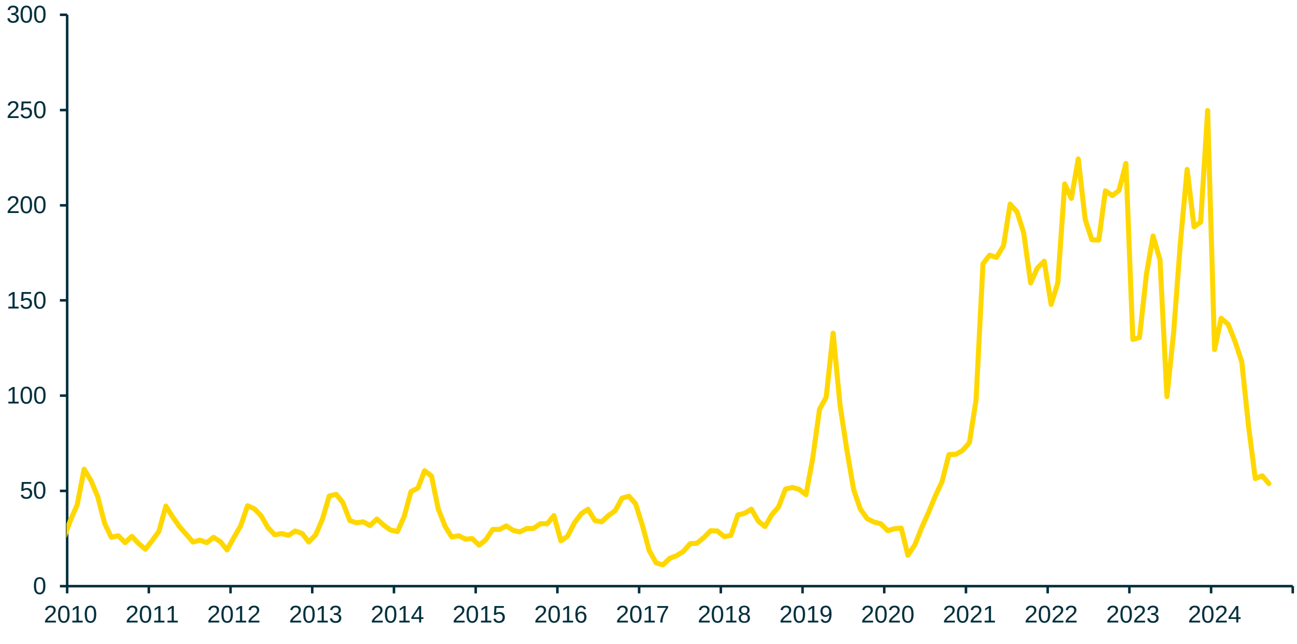
Together with increased spending in some areas (especially defense), implementing Trump's proposals could result in additional deficits of $7 to $8 trillion. By way of comparison, the Congressional Budget Office projects a deficit of $22 trillion over ten years based on current legislation, which corresponds to an average of 6.3% of GDP. Trump would likely push the deficit above 8%.

(c) Immigration

High immigration, especially illegal immigration, was one of the central issues in the election campaign. Donald Trump promised to deport illegal immigrants. Many of these immigrants work in labor-intensive sectors such as construction, agriculture or hospitality. If there are mass deportations in these sectors, wages in these areas are likely to rise. This would have a further inflation-increasing effect.
However, the US seems to be getting the immigration problem under control, thanks in part to a change of course by the Biden administration. The number of illegal immigrants apprehended at the border with Mexico has fallen dramatically in recent months (Chart 1).

Donald Trump could therefore confine himself to a few thousand deportations staged for maximum media impact and otherwise concentrate on securing the border. This would avoid the economically disadvantageous consequences of large-scale deportations, while at the same time securing the political gain. We therefore do not expect him to carry out his threats here.

Chart 1 - Has the immigration wave already peaked?
US Border Patrol apprehensions of immigrants on the US southwest border, monthly data in thousands



Source: US Customs and Border Protection, Commerzbank Research

Effects on growth...

The tariff increases are likely to have a certain positive effect on growth in the short term, as some US demand will ultimately be diverted to domestic products. However, the retaliation by trading partners that is likely to follow will weaken the effect in the medium term. Escalating trade disputes – or even the mere risk of them – will increase economic uncertainty. Companies will have to reorganize their supply chains, which will lead to additional costs. Planning certainty will be reduced, at least for a time. In such an environment, companies are likely to be reluctant to invest.

... and on inflation

The most pronounced impact of Trump's plans is likely to be felt in the area of inflation. If he does indeed impose a tariff of 60% on imports from China and 10% on all other imports, both effects could lead to a price increase of 1 percentage point each. However, a lower pass-through to consumers and an appreciation of the dollar could dampen these effects. In our view, it is a realistic assumption that new tariffs will come into force from around mid-2025, which could increase the price level by around 1 percentage point over a twelve-month horizon.

Is there a risk of conflict with the Fed?

The Fed is in a difficult position due to the upcoming change in policy. Even now, neither the market nor the Fed members themselves are entirely sure that the series of interest rate cuts originally expected will actually be implemented. The Fed, in its own words, is conducting monetary policy on a meeting-by-meeting basis. The interest rate cut expected for tomorrow and probably also the one in December are relatively certain. By spring at the latest, when it becomes apparent that the tariffs will be implemented, the environment for the Fed's decisions will have changed significantly. We therefore expect the Fed to stop the rate cuts at 4.00% (previous forecast: 3.50%; the upper bound of the target corridor is currently 5.00%). However, the central bank is unlikely to officially declare the end of the rate-cutting cycle, but will instead refer to the data.

President Trump, however, would probably see a key rate as high as this for a long period of time as an unfriendly act and fear a headwind for his plans. Nevertheless, we do not expect him to be carried away into a direct attack on the Fed's independence. This would cause massive upheaval in the financial markets. During his first term in office, Trump always placed a great deal of emphasis on the healthy development of the financial markets. Trump will therefore probably limit himself to public criticism and wait for the seats on the Fed Board to become vacant (Jerome Powell's term of office as Chairman of the Board ends in spring 2026).

How are the markets reacting?

Initial market reactions show a significant increase in Treasury yields, by around 15 basis points for 10-year paper. This is likely to reflect concerns about a higher supply of government bonds due to rising budget deficits and inflation risks.

At the same time, the dollar appreciated very significantly, by around 1.1% against the average of the G10 currencies. Obviously, investors believe that the Trump presidency will be USD-positive. That may be so. If Trump actually implements his inflationary measures (in particular high import tariffs and deportation of a significant portion of the US labor force), but at the same time, contrary to his statements, does not interfere with the Fed's independence, the dollar will appreciate.

However, we are more cautious, especially since it is unlikely but not impossible that the Fed's independence will be damaged. Therefore, we consider the trend towards additional USD strength to be an exaggeration until it is certain that the USD-favorable policy mix assumed by the market will actually materialize.

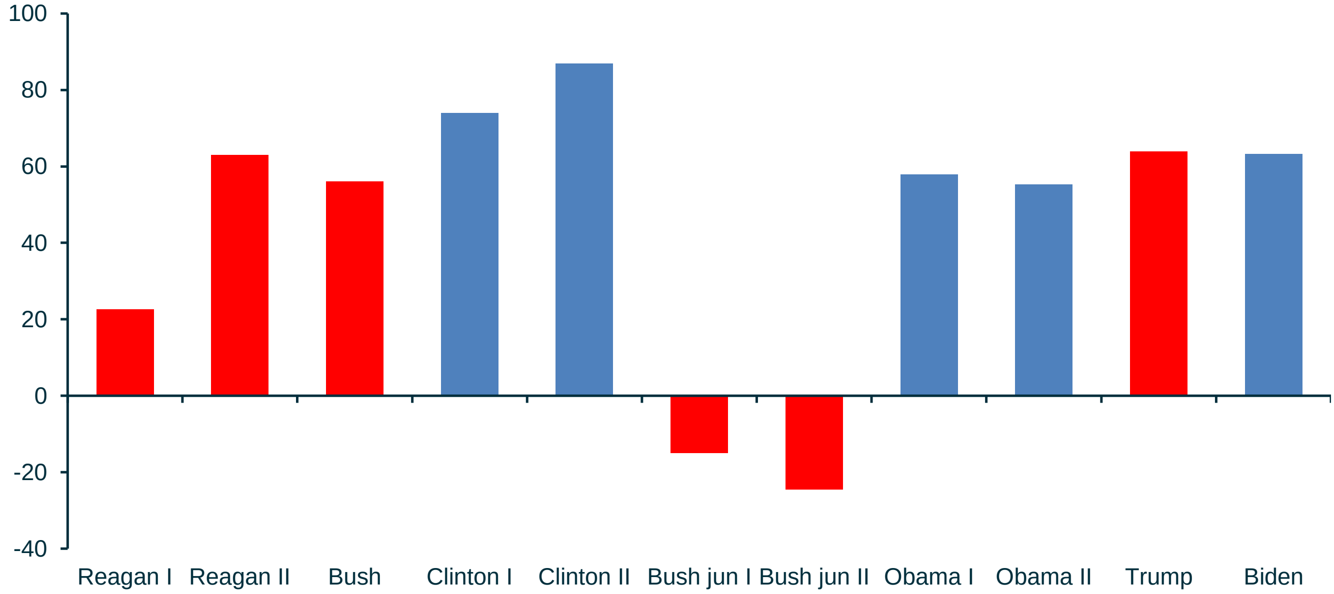
If inflationary measures were to be taken but at the same time the Fed were to be put on a tight leash, such a policy mix would lead to a very significant weakening of the USD. All in all, we therefore see the medium to long-term risks for the USD as asymmetrical. There may be a higher probability of further USD strength, but more likely in moderate steps. On the other hand, anything that calls into question the Fed's independence has the potential to trigger significant USD weakness. This is less likely, but would have a greater impact.

The fact that 1Y-EURUSD riskies remain in negative territory does not fit in with this. The FX market needs to adjust.

In the stock market, the market influence of politics should not be overestimated in the longer term. The S&P 500 stock index, for example, recorded relatively similar gains under the last few presidents (Chart 2). The only exceptions were the two terms of George W. Bush, when the technology bubble burst and the Lehman bankruptcy rocked the markets.

Chart 2 - Presidents have limited influence on the equity market

S&P-500 share price index during Presidential terms (calculated from November in the election year until next election), changes in %. Red colums: Republican presidents; blue colums: Democratic presidents



Source: S&P Global, Commerzbank Research

[1] In many respects, Robert Lighthizer is the intellectual force behind protectionist US trade policy. He summarizes his core thesis in the introduction to his book “No trade is free” (2023) as follows: "Simply put, I believe that American trade policy should revolve around helping working-class American families. Enhancing corporate profits, increasing economic efficiency, and lowering consumer rices are important but, in my view, secondary to this goal. When I look at the world today, the only practical way to help the working people I see is to support the American manufacturing sector". (back to text)

[2] Our assessment is based on: "**Trump II Tariffs: Who said he could do that?**", Alan Wm. Wolff, Peterson Institute for International Economics. (back to text)

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