Mr. Trump's impact on our forecasts

Donald Trump has clearly won the US presidential election and will take office as the 47th President of the United States on January 20. Given the strong mandate he received, he will probably be able to push through many of his projects. We show what this means for the economic outlook and adjust our forecasts.

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Donald Trump has done it: he is moving back into the White House after being voted out in 2020; this is only the second example in US history of an "interrupted" presidency [1]. The Republicans also won a majority in the Senate. This will make it easier to appoint senior government officials who require Senate confirmation. And the Republicans might also achieve a narrow majority in the House of Representatives; however, the result is still uncertain. Trump has thus received a strong mandate from the electorate to implement his agenda.

US: the implementation of Mr. Trump's agenda...

During the election campaign, Donald Trump aired numerous ideas and plans, not all of which will survive contact with political reality. Many details are still unknown, and the plans are likely to change in the course of the legislative process. However, some guidelines of the Trump-II administration are emerging clearly:

- Trump sees tariffs as a panacea. A general tariff of at least 10% and a tariff rate of 60% on imports from China are being discussed. If all of this is implemented, the US's average tariff rate would rise to its highest level since the 1930s.
- At the end of 2025, the income tax cuts that Trump passed in his first term will expire. Trump wants to extend them completely and has also promised a further reduction in the corporate tax rate (currently 21%).
- How the plans will be financed is unclear. The increased tariff revenues will not even come close to covering the holes torn by lower taxes, and at least in the short term, tax cuts cannot be expected to be fully self-financing through their growth-promoting effect. Rather, the already high budget deficit is likely to widen. We expect the shortfall in the budget year 2025 (ending September 30, 2025) to be around 7% of GDP (previous forecast: 6.3%) and in 2026 to be just under 8% (previously: 5.9%).

... will only boost growth moderately, ...

We assume that the tariff increases vis-a-vis China will probably come into effect in full, while the others will only be partially implemented (here, the threat of higher tariffs may also serve as leverage to persuade trading partners to make concessions). Together with the expansionary fiscal policy, this will boost demand for domestic products, at least for the time being. However, this stronger demand will be met by an economy that is already operating at high capacity, meaning that US companies will only be able to expand their supply to a limited extent. In addition, there are considerable uncertainties, for example with regard to the global economic environment, which has been disrupted by a trade war, that in themselves will curb investment. We therefore expect growth in 2025 to be only slightly higher than our previous forecast of 2.0%, at around 2.3% (about $^1/_2$ percentage point above potential growth).

... but inflation significantly

A more pronounced effect can be expected in terms of inflation. US consumer prices are likely to rise due to an increase in the price of imports and a shift in demand towards domestic products that were originally more expensive, especially since many companies will also use the increase in demand to expand their profit margins. Overall, these effects will cause prices to rise by an additional one percent, with the price-driving effect starting around mid-2025. The average inflation rate for 2025 would then be 2.5% (previous forecast: 2.3%).

Fed to end rate cutting in spring

The renewed strong fiscal impulse, with its expected inflationary effect, puts the Fed in a difficult position. After yesterday's 25 basis points rate cut, we expect further cuts in December and early next year, whereby the Fed would reduce the degree of restriction of monetary policy. From then on, however, Trump's plans are likely to take shape and the first negative effects on inflation and inflation expectations can no longer be overlooked. We therefore now expect the Fed to cut its rates only to 4.00% (upper bound of target range; previous forecasts: 3.50%).

Euro area: higher inflation risks

Trump's economic policy will also have a noticeable impact on economic development in the euro area – in both the short and long term. In principle, a general increase in US tariffs would significantly increase US demand for goods produced in the US and reduce demand from the rest of the world, including for products from the euro area and Germany. This demand effect would in itself reduce inflation in the euro area. However, the EU would probably respond with counter-tariffs, which would make imports to the EU more expensive and thus, in itself, push up inflation. This cost effect is likely to outweigh the demand effect somewhat because the EU, which is already prone to protectionism, could also raise its tariffs on other countries.

However, we do not expect Trump to impose the threatened tariffs on Europe immediately and in full; instead, he will use them as leverage in negotiations to push the EU into making concessions. That said, Trump's tariff policy is creating a climate that is destroying the last remnants of rules-based trade policy, meaning that the inflation-driving deglobalization is likely to accelerate anyway. All in all, this increases the risk of inflation in the euro area, especially if the trade disputes escalate. However, this inflationary effect is mainly a threat from 2026 onwards, because the EU is likely to impose counter-tariffs only after unsuccessful negotiations with Trump's USA.

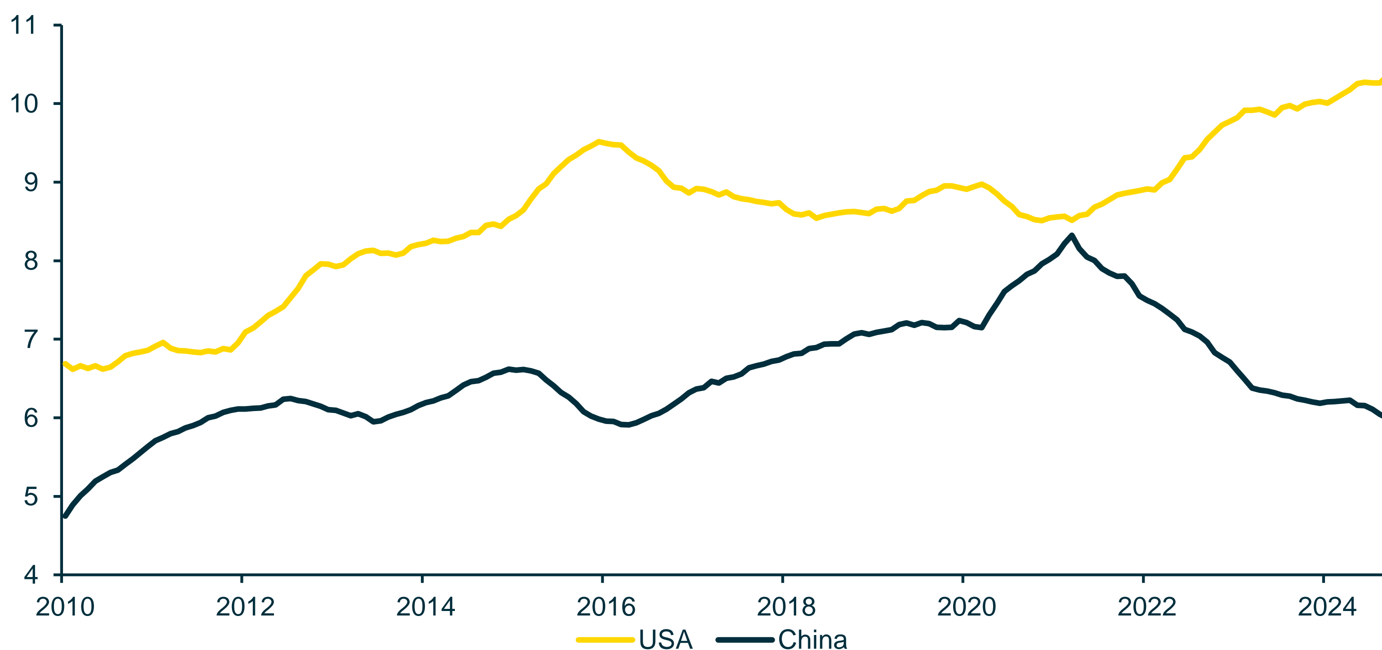
Growth risks only after 2025

Our expectation of slightly higher US growth is partly due to higher US tariffs, which are diverting demand to the US at the expense of the eurozone. However, the stronger dollar caused by tariffs argues for slightly more growth in the eurozone, as it increases the price competitiveness of goods produced in the eurozone. All in all, the influences are likely to cancel each other out to a large extent by 2025, which is why we are confirming our forecast for the eurozone of 0.9% (Germany: 0.2%).

If we look beyond the short term and consider the long term, the negative effects of Trump's economic policy for the euro area are clearly predominant. His tariff policy promotes deglobalization and weakens the international division of labor. This is likely to affect Germany in particular as an export nation. After all, the US is the most important export market for German companies (Chart 1).

Chart 1 - The US is Germany's most important export market

Share of goods exports to the US and China as a percentage of total exports, 12-month moving averages



Source: Destatis, S&P Global, Commerzbank Research

ECB to cut rates a bit less than expected before

The signs of higher US inflation and slightly higher growth in 2025 suggest that the Federal Reserve will cut interest rates less. This would have no direct influence on the ECB. As the central bank of a currency area of a similar size to the US, the ECB has sufficient leeway for its own monetary policy. However, the increased inflation risks from counter-tariffs in 2026 argue less strongly for an ECB

interest rate hike. We are refraining from the planned, but so far unpublished, further key interest rate cut to 1.75% and are leaving our forecast for the ECB deposit rate at 2.0% by mid-2025.

Market reactions

Equities...

The immediate market reaction was a strong rise in US stocks, while German stocks came under pressure (title graphic). In the stock market, however, the market influence of politics should not be overestimated in the longer term. For example, the S&P 500 stock index recorded relatively similar gains under the last few presidents.

Dollar...

The dollar appreciated markedly as the election result emerged. Investors evidently believe that a Trump presidency will be positive for the USD. This assumes, however, that the future incumbent will implement his inflationary measures while at the same time not infringing on the Fed's independence, contrary to his indications. We are not so sure that a President Trump will stay completely out of US monetary policy. Therefore, we consider the trend towards additional USD strength to be exaggerated – at least until it is certain that the USD-favorable combination assumed by the market will actually materialize.

We therefore see only limited upside potential for the dollar based on current exchange rates. However, at 1.05, our new forecast for spring predicts that the dollar will be significantly stronger than previously expected (old forecast: 1.11). After that, it is likely to become apparent that not all of the plans can be implemented, whereupon the dollar will probably weaken slightly again. We expect the EUR-USD exchange rate to be 1.07 at the end of 2025 (previous forecast: 1.09).

The medium to long-term USD risks are asymmetrical. It is more likely that the USD will continue to strengthen, but more likely that it will do so only to a moderate extent and in stages. 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.

...and yields

The US bond market has reacted in a textbook way to the increased inflation and fiscal risks posed by the election result. Long-term yields have risen significantly, with the market expecting higher inflation in the medium to longer term and, consequently, fewer interest rate cuts by the Fed.

In the short term, US yields are likely to rise further before a temporary fall in inflation and a few more interest rate cuts by the Fed in the spring should help to calm the situation somewhat. However, since we now expect the Fed to end the interest rate cycle earlier, US yields are likely to remain higher than previously thought. We have raised our US yield forecasts by around 50 basis points.

In Europe, on the other hand, growth concerns dominate, so that German government bonds will probably decouple from developments in the US market for the time being. In the longer term, however, we consider it unlikely that Bunds will be able to decouple from US Treasuries permanently. The traffic light shutdown adds to the upside risks at the long end.

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[1] The only other person to achieve this feat was Grover Cleveland, the 22nd president (1885-1889) and 24th president (1893-1897). (back to text)

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