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ECONOMIC TALKING POINTS

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Trump Wins: Now What? Lots of Policy Promises --- But What Will Emerge?

It was Shakespeare's shrewd observation about people in his lesser known *Henry IV Part 2* that pretty well sums up the last 24 hours: "The spirits of the wise sit in the clouds and mock us."

The well-paid pundits, pollsters and political prophets got this election embarrassingly wrong.

Like many economic forecasters, our own projections were based on the convergence of polls pointing to a Clinton presidency. Under that assumption, we saw the economy picking up speed next year, along with a sleepy upward slope in interest rates and the very real prospect this business cycle could exceed the 1990s record of ten straight years with growth.

What now? Trash the economic and political models.

We've cleaned our white board and now turn, as least initially, not to what Trump has promised to do on trade, health care and taxes, or about the legion of foreign policy issues facing this country. Instead, the path of the economy will likely be determined by what American are thinking and doing in the aftermath of this election.

Though Trump has been on the campaign trail for some two years, he still remains a staggeringly enigmatic person. Case in point: One moment you hear Trump discuss the need to reform taxes, overhaul health care and fix America's decrepit infrastructure, only to be followed a short time later by outbursts that resembles

coprolalia. And if you add to this bizarre personality mix the fact that Trump has never before held public office, then Americans will quickly realize they put into the White House a figure that represents the mother of all uncertainties. This is precisely what a fragile eight-year old recovery does not need.

So our first conclusion is we will likely see a major retrenchment in spending by households and business. There are just too many profound questions that immediately bubble up with a Trump presidency.

1. Will he soften his stance on trade with Mexico and China? If not, can the US economy, which is barely growing at 2%, withstand a trade war?
2. Will Trump step back from his threats to punish Ford, Carrier, Apple and other firms that shifted manufacturing plants overseas only to bring their products back to the US?
3. Will Trump's condemnation of Obamacare be replaced by another plan that eases household concerns about future health care coverage?
4. Will Trump soon seek Janet Yellen's resignation and inject his own politics into the conduct of monetary policy?
5. Will Trump's vociferous condemnation of the West's nuclear accord with Iran cause Teheran to abort the agreement and move full speed ahead with its nuclear military program? How will Israel and Saudi Arabia then react?
6. Will Trump use America's military power stand up to China's discredited claim of sovereignty over the South China Sea? If so, is a military confrontation in the region inevitable? Or, will Trump choose a more passive approach and resign himself to China's sea claims. If so, will not Asian nations turn away from the US and seek out new relationships with Beijing?
7. Will Trump's victory further erode the fragile state of the European Union? Could elections coming up in Italy, France, Germany and the Netherlands result in the fragmentation of the European Union?
8. Could Russia's Vladimir Putin feel more emboldened to grab and annex all of Ukraine and threaten even the Baltic States, who are now part of NATO?
9. Given the Republican control over the Senate and House, will Trump's future nominees to the Supreme Court roll back Roe vs. Wade and Obergefell vs. Hodges? Could that spark serious unrest around the country?
10. Will a President Trump acquiesce to having his entire business empire be transferred into a blind trust that is out of the control of his family? If not, does that set up a dangerous precedent, if not a constitutional crisis?
11. By thrashing the Trans-Pacific Partnership (TPP), NAFTA, and the Transatlantic Trade and Investment Partnership (TTIP), will we see world trade shrink by an amount not seen since the Great Depression?

12. Last, but not least, what kind of people will Trump appoint to key positions in government? The best and the brightest with unquestioned integrity --- or political sycophants who will pusillanimously carry out the President's directives?

We will not know the answers to these and many other questions for a while. As a result, we expect to see a pull back in demand for goods and services in the US. Consumers are less likely to purchase big-ticket items, like autos and homes, given the economic uncertainty ahead. Businesses will delay major capital spending projects until there is greater clarity on how the US and international economy responds, and whether such capital investments will earn an adequate return.

With a Trump victory, our GDP forecast has materially changed. A blanket of uncertainty now hovers over the private sector of the economy. The cost of that uncertainty should be palpable. Growth will reverse course fairly significantly.

Instead of 2.7% growth next year, we see the economy expanding at less than 1% in 2017, with a 60% chance of a mild two-quarter recession.

As for monetary policy, the Federal Reserve will now be closely monitoring the performance of the financial markets as well as weekly and monthly economic indicators.

I believe the Fed's inclination is still to raise rates next month. Remember, the Fed needs some room to lower them again next year if the economy starts to wobble under a Trump Administration. For if the central bank doesn't act at the year's final meeting and the economy stumbles, Yellen and her colleagues may have little choice but to pursue the more distasteful option of negative interest rates.

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