Trend Macrolytics, LLC
Donald Luskin, Chief Investment Officer
Thomas Demas, Managing Director
Michael Warren, Energy Strategist

POLITICAL PULSE

Trumponomics II, The Sequel

Wednesday, July 17, 2024
Donald Luskin

November is a long way out, but let's start to answer client questions about a second term.

The failed attempt to assassinate Donald J. Trump has changed the game. It makes Trump look both sympathetic and heroic, which one might well have thought would not be an easy thing to do. It draws a stark contrast between his robustness and Joseph R. Biden Jr.'s evident infirmity (see "Our Hot Take on Last Night's Presidential Debate" June 28, 2024). And it shames the Democratic messaging that has consistently portrayed Trump as a Hitler-like threat to democracy itself, giving moral license to any messianic crackpot who wants to save the world by taking him out (it's amazing it has taken this long).

With almost four months till the election, anything is still possible (if we've learned nothing else this year, it is *that*). But from where we are now, with Trump ahead in all seven battleground states that determine the presidency (outside the margin of error in all but one, Michigan), *we have to assume that Trump will be the next president. We continue to believe that Republicans will regain Senate control and will likely narrowly continue to hold the House (regardless of who is elected president).*

This alters the equation for Biden remaining the Democratic candidate. The shooting shifts attention to Trump, and therefore takes Biden out of the intense glare of public scrutiny and criticism (since the debate, Trump has done an uncharacteristically good job of staying out of the spotlight, putting Biden's troubles in the bullseye, as it were). It creates a new news cycle, so *if Biden wishes to continue to resist replacement, he probably can do so now*. At the same time, though, if Trump is the likely winner, there is less reason for Biden to want to stick around and lose to him. But there is also less reason for the party to go through the chaos and humiliation of switching him out (*which probably rules out the use of the 25th Amendment to remove him from office forcibly, which we had said would be a risk-off trigger event for markets* – see "Our Hot Take on Biden's Stephanopoulos Interview" July 6, 2024), or for that matter, for any alternate candidate to be willing to be the sacrificial lamb. All that said, Biden's self-evident frailty raises the question of whether he can survive the campaign schedule he now seems committed to pursuing as energetically as he can.

So let's assume it's Trump versus Biden. And let's assume Trump wins. What does four years of Trumponomics, with at least the first two years

Update to strategic view

US MACRO: The failed attempt to assassinate Trump has increased the chances of his re-election. It has also increased the likelihood that Biden will remain the Democratic candidate, removing a potential risk-off event for markets if the 25th Amendment had to have been invoked. Republicans will control the Senate for sure, and likely the House by a small margin, even if Trump loses. The most important economic consequence of a Trump presidency would be the installation of a strong cheerleader for the economy, energizing "animal spirits" even among Democrats. Trump will not fire Powell, having admitted in 2018 he lacks the authority to do so. The extension of the expiring 2017 tax cuts would not be a budget-buster, as they are now more than paying for themselves. Trump's debt record is no more profligate than Biden's, with half the debt created in his first term arising in the last ten months during the Covid emergency, on a bi-partisan basis. Tariffs are not necessarily inflationary, and may…

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supported by a congressional majority, mean for the economy and the markets?

It's complicated.

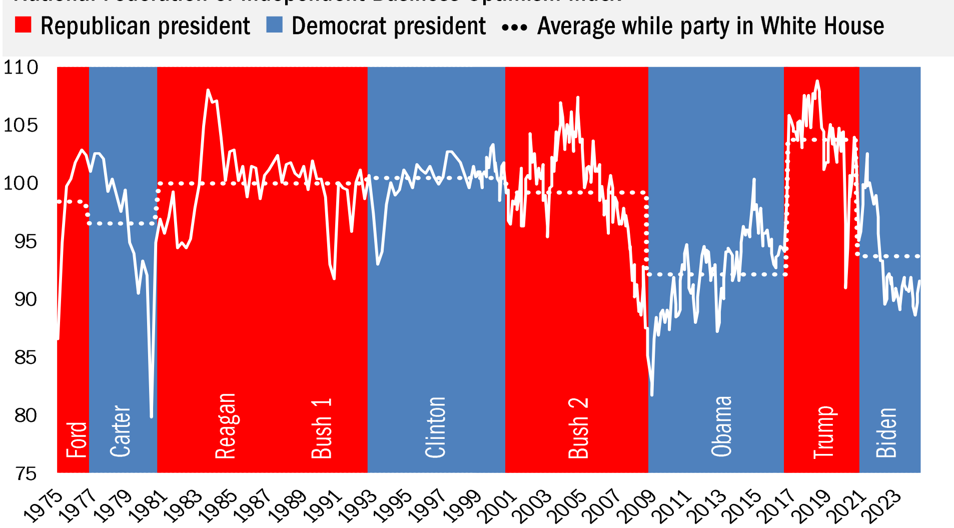
But it's also very simple. Whatever complex forecasts we want to make for Trump's tax, regulatory, trade, immigration and Federal Reserve policies, there is one thing we know for sure: *he is a highly effective cheerleader for the "animal spirits" that animate the economy*. His flamboyant and often hyperbolic style is like that of a football coach making a speech to the team at half-time exhorting you to pull yourself up by your own bootstraps and go out there on the field and come from behind and win – it's corny, and *it's full of B.S. (and you fully know that when you hear it) – but it still works, and it works even if you are a Democrat*.

- So far the stock market seems to think it will work, with the S&P 500 up 3.3% as of yesterday's close -- an all-time high – since Trump's seeming ascendancy began on June 27 with Biden's disqualifying debate performance. The Russell 2000 is up 1.69%, to the highest level since late 2021.

It's quite a contrast to Biden's negative messaging to the grass roots of the economy (such as, for example, saying in his recent press conference, incorrectly, that "Grocery prices have fallen since the start of the year," and that he will "keep working to take down corporate greed to bring those prices down further" and, also incorrectly, that "corporate profits have doubled since the pandemic. They're coming down. And so, I'm optimistic about where things are going." Hard to see how it helps animal spirits to tell businesspeople their greed caused the inflation that has tortured them, and that their falling profits are cause for optimism.

- The National Federation of Independent Business Optimism Index (please see the chart below) had the highest reading in the history

National Federation of Independent Business Optimism Index



Source: NFIB, TrendMacro calculations

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… not be anti-growth, depending on the incidence of their payment. Broad tariffs would require legislation and would unlikely get past even a GOP Congress. Trump's de-regulatory stance would benefit not just energy, but banking as well. The worst risk is sealing the border. Mass deportation would be a disaster on the scale of the Great Recession but is not logistically possible. Slowing the flow of immigrants would reduce job creation and slow both production and consumption.

[Strategy Dashboard home]

of the data during Trump's presidency (and the highest average, even given the pandemic). Readings for the last two years under Biden have been lower than in the depths of the pandemic (and, on average, the second lowest for any period in which either party held the White House).

- Republican periods all score higher than Democrat periods, with the exception of the presidency of Bill Clinton, who was quite a cheerleader.

As the election comes closer, we'll have a lot more to say about the economic policy environment that appears to be emerging. Particular policy choices will be important, and we will get ahead of them. *That said, we think the general over-arching "animal spirits" environment is more important than any policy, and it's also something that we think we can predict with great confidence under a second Trump presidency.*

For now, though, we will take a quick tour through the landscape of Trumponomics, and at least touch on some of the questions we are getting from clients.


Steven Mnuchin
@stevenmnuchin1

(1/2) I have spoken with the President @realDonaldTrump and he said "I totally disagree with Fed policy. I think the increasing of interest rates and the shrinking of the Fed portfolio is an absolute terrible thing to do at this time,...

5:02 PM · Dec 22, 2018

Steven Mnuchin
@stevenmnuchin1

(2/2) especially in light of my major trade negotiations which are ongoing, but I never suggested firing Chairman Jay Powell, nor do I believe I have the right to do so."

5:03 PM · Dec 22, 2018

WILL TRUMP RE-IGNITE INFLATION BY FIRING JEROME POWELL?

Clients widely believe that Trump is an easy-money advocate, and indeed his hectoring of Fed chair Jerome Powell to cut rates in 2018 would give that impression. That said, Trump himself admitted that same year that he doesn't have the authority to fire him (please see the two tweets at left). He told Bloomberg yesterday that he would let Powell finish out his current term, but "especially if I thought he was doing the right thing."

- Section 10 of The Federal Reserve Act gives the president the power to remove any Federal Reserve Board Governor "for cause." It does not empower the president to demote a chair to a mere governor. If "for cause" can be broadly construed to include policy disagreements, then it's hard to see how a president could remove just the chair, considering that policy is determined by the whole FOMC – he'd have to fire them all, or at least the majority voting for the bad policy, and that's surely a bridge too far.
- Over time, Trump could populate the Board with people who matched his supposed easy-money preferences. Fair enough, except that he's always done just the opposite. It's thanks to Trump that we have Christopher Waller on the Board, one of the most dogmatic hawks we've ever encountered. Steve Moore and Judy Shelton, whom he nominated to the Board but were rejected by the GOP-dominated Senate Banking Committee, are longstanding

Contact TrendMacro

On the web at
trendmacro.com

Follow us on Twitter at
twitter.com/TweetMacro

Donald Luskin
Dallas TX
214 550 2020
don@trendmacro.com

Thomas Demas
Charlotte NC
704 552 3625
tdemas@trendmacro.com

Michael Warren
Houston TX
713 893 1377
mike@trendmacro.energy

[About us]

darlings of movement conservatives precisely because of the primacy of inflation-fighting in their policy frameworks.

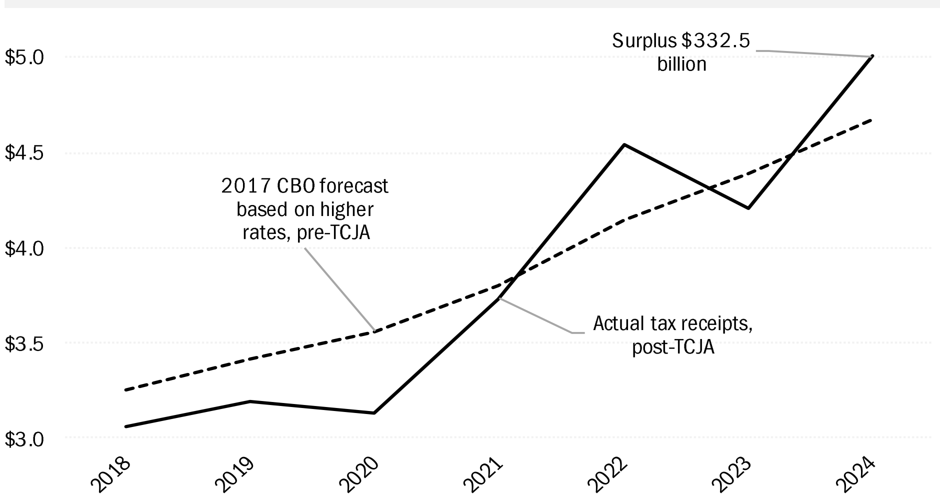
WILL TRUMP BLOW OUT THE BUDGET BY EXTENDING THE 2017 TAX CUTS? The 21% corporate tax rate was legislated to be permanent under the 2017 Tax Cuts and Jobs Act. But many lower rates and higher brackets for individuals, exclusions for estates and the cap on deductibility of state and local taxes will sunset at the end of 2025. Biden has said he would let them expire (at least for households making more than $400,000 per year) – but President Trump, even with a narrow congressional majority, would certainly extend them.

One can argue that extending the expiring provisions would increase deficits. You hear it constantly. And perhaps they would – at least versus a baseline assumption such as that of the Congressional Budget Office in which the tax cuts are assumed to expire. But such modelling always fails to account for the dynamic feedback effects of tax policy, in which tax hikes seem to never produce all the expected revenues, and tax cuts never seem to produce all the expected costs.

We have already discussed these dynamics in some detail (see "Video: What you're not hearing about extending the 2017 tax cuts" May 9, 2024), especially with respect to the corporate tax rate (see "Video: What you're not hearing about raising the corporate tax rate" April 17, 2024). But we have not dealt with *total overall* actual tax receipts at the post-TCJA low rates versus the CBO's expectations at the pre-TCJA higher rates.

- The surprising truth is that, projected on a fiscal year-to-date basis, and adjusted for actual inflation, *tax revenues at the lower post-TCJA rates are $332.5 billion higher than the CBO projected if there had been no tax cuts at all* (please see the chart below).
- The tax cuts didn't "pay for themselves" *immediately*. And there

Federal tax revenues (USD trillions, adjusted for inflation ex-post)



Source: US Treasury, CBO, TrendMacro calculations

was the pandemic depression in there, too – and the recovery from it. *But the important point going forward is the run-rate – the Treasury is taking in more money at low rates than it expected to do at high rates. So why rock the boat?*
- The bond market isn't worried. Since the debate, the 10-year Treasury yield is lower by 12 bp. If Trump were such a budget-buster, yields would be higher now.

BUT ISN'T TRUMP A BIG SPENDER? We suppose so, but he is not uniquely a big spender. Under Trump's first term, US debt increased $7.8 trillion. Under Biden's term (adjusting for the fact that all four years have not been completed), debt increased by $8.3 trillion.

- $4.1 trillion of Trump's debt increase, 48% of the total, occurred in his last 10 months in office thanks to two large pandemic-relief bills. Arguably the second bill was unnecessary, and indeed inflationary, but both passed by Congress with overwhelming bi-partisan majorities.
- Trump was not unique in signing gigantic pandemic-relief bills. Biden did the same thing, signing the third such bill – even more likely to have been unnecessary – two months after taking office. One difference is that Biden signed a bill that passed Congress on a straight Democratic party-line vote.
- To be sure, Trump can be faulted for having done nothing whatsoever to rein in entitlement spending. Considering the wishes of the movement conservative base in his party, this may seem especially frustrating if only because it is ironic. But Biden has done nothing either – nor has any other president.
- So why worry that the economy will be particularly affected if Trump just continues on a well-worn policy path?
- Let us repeat: the bond market isn't worried. Since the debate, the 10-year Treasury yield is lower by 12 bp.

WILL TRUMP TRIGGER INFLATION AND SLOW GROWTH WITH TARIFFS? We are generally opposed to protective tariffs. But there's no particular evidence that Trump's tariffs against imports from China imposed in his first term had any real-world consequences for growth or inflation. Be that as it may, Biden, having campaigned on reversing Trump's tariffs, instead increased them – and he is threatening to do so again this morning. So here too, unless Trump increases tariffs dramatically, we would hardly see this as a unique shock.

- *Tariffs are not necessarily inflationary*, even though – as a tax on the wholesale importation of goods for resale – they would seem to add to the costs of goods to consumers as the tariff is passed along. But don't be so sure the tariff will be passed along. The domestic supply chain might, instead, opt for allowing margin compression – in which case *the tariff is a decrement to growth, not an increment to consumer prices*.
- But even if the tariff is passed along, it wouldn't necessarily be inflationary. Consumers facing higher prices for imports, and

constrained by their budgets, would have to buy fewer units of domestically produced goods to the extent they didn't wish to substitute out of imports. So prices for domestically produced goods would fall, offsetting the inflation in imports. There would be a contraction in the consumer economy as fewer units are transacted overall – but here, again, that's a growth problem and not an inflation problem.

- But would it really be either kind of problem? That depends on what you believe about the "incidence" of the tax – that is, who really pays it? On the surface, the importing wholesaler pays it. But what if the foreign exporter lowers his prices to the importing wholesaler in order to ensure that volumes will be preserved? What if the exporter's government subsidizes that? Then *no American actually pays the tariff – and both prices and unit volumes are conserved.*
- As a practical matter, Trump was able to impose his three rounds of tariffs on China in his first term under various emergency laws giving the president the authority to punish dumping, other nations' unlawful tariffs, subsidies and intellectual property theft – and for national security concerns. *The across-the-board tariffs Trump is now campaigning on couldn't be enacted that way – they would require legislation, and it's far from obvious that a narrow Republican majority in Congress, which would include many classical pre-MAGA free-traders, would go along with it.*
- As to Trump's intention to use new tariffs to make it possible to eliminate the personal income tax, well, that's classic Trump hyperbole. The arithmetic doesn't even begin to work, no matter how high the tariff rate. But like most of Trump's hyperbole, the direction of it tells you how he's thinking: he is cognizant that tariffs are taxes, and that he is proposing a tax hike, and he intends to offset it.

WHAT ABOUT TRUMP'S REGULATORY OUTLOOK? We get no questions about this from clients because the answer is obvious. *Trump wants to deregulate the economy* – and we don't think there's much argument, even from Democrats, that Biden has done anything but increasingly regulate it. The obvious beneficiary is energy – we say that because it has been a particular target of the Biden administration. But don't forget about banking. In the wake of the Silicon Valley Bank failure, regulation has become smothering. All that can, and will, change under Trump.

- There is arguably a nexus to inflation here. Deregulating US energy production and transport will surely lower prices. Yes, we think inflation is everywhere and always a *monetary* phenomenon. But at least in the short term – and the conventional wisdom holds that it's much more that that – energy prices are an important direct and indirect determinant of the price level.

FINALLY, WHAT ABOUT THE BORDER ? We're not going to belabor it here, because we have written so much about it already (see "Video: What you're not hearing about the effects of immigration on the post-pandemic boom" April 9, 2024; "Open Borders Produced the Biden Economic Boom" May 24, 2024; and "Video: What you're not hearing about who are all those new immigrants in the labor force" May 31, 2024). *As lawless and chaotic as the southern border has been during Biden's administration, it has nevertheless been a strong source of economic growth. Trump's signature promise to seal the border would, if he could actually do it, slow some or all of that growth*.

- Of the more than 3 million adult immigrants who have entered the US over the last 23 months since the labor market normalized after the pandemic lockdowns, 60% have jobs. That matches the employment-to-population ratio of the general population. The match suggests that immigrants are not parasitically taking jobs from the native-born.
- Those jobs represent about three quarters of all new employment over the period. Without them, payroll growth would have been, on average, about 165,000 less than reported each month. So for example, the June jobs report two weeks ago would have shown not 206,000 net payroll, but only 41,000 (see "On the June Jobs Report" July 5, 2024).
- Trump's campaign promise to deport the over ten million illegal immigrants living in the US, if he were able to implement it, would be a catastrophe for both production and consumption. We estimate it would drive a permanent drop in GDP roughly equivalent to the temporary drop experienced in the 2008-2009 Great Recession. Fortunately it entails a manpower and logistical challenge that can simply not be mastered – so however much he means it, it will not happen. He promised the same thing in the 2016 campaign and didn't even try to implement it.
- While mass deportation is surely impossible, sealing the border to some extent is very possible. Of all the economic risks associated with Trumponomics 2.0, we consider this the most salient, and will track it the most closely.

Bottom line

The failed attempt to assassinate Trump has increased the chances of his re-election. It has also increased the likelihood that Biden will remain the Democratic candidate, removing a potential risk-off event for markets if the 25th Amendment had to have been invoked. Republicans will control the Senate for sure, and likely the House by a small margin, even if Trump loses. The most important economic consequence of a Trump presidency would be the installation of a strong cheerleader for the economy, energizing "animal spirits" even among Democrats. Trump will not fire Powell, having admitted in 2018 he lacks the authority to do so. The extension of the expiring 2017 tax cuts would not be a budget-buster, as they are now more than paying for themselves. Trump's debt record is no more profligate than Biden's, with half the debt created in his first term arising in the last ten months during the Covid emergency, on a bi-partisan basis. Tariffs are not necessarily inflationary, and may not be anti-growth, depending on the incidence of their payment. Broad tariffs would require legislation and would unlikely get past even a GOP Congress. Trump's de-regulatory stance would benefit not just energy, but banking as well. The worst risk is sealing the border. Mass deportation would be a disaster on the scale of the Great Recession but is not logistically possible. Slowing the flow of immigrants would reduce job creation and slow both production and consumption.