Trump wins – But he is going to struggle to unite his party and the country

The United States has elected a political outsider as President. Overall, the outcome was largely unexpected, leading to a high level of political and economic uncertainty.

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Donald Trump has emerged victorious over Hillary Clinton in a Presidential election that has defied expectations. Every single election poll in the past four months predicted a Clinton victory. But not only did Trump win more than 270 of the electoral votes, overturning many states that were previously held by Democrats, he also won the popular vote. The Republicans also have control of the Senate and the House of Representatives, giving them control of the US Congress.

The outcome of the election is another clear indication of the rise of right-wing politics, in-line with the Brexit vote. It will be seen as an anti-establishment vote, a vote for self-determination, the protection of jobs and anger at how Washington has ignored the middle class American.

US President has limited powers

It is important to recognise that within the United States' political system, a number of checks and balances exist to prevent the President from having free reign. In other words, in contrast to the many powers it gives Congress, the US Constitution grants few specific powers to the President. The President has the authority to nominate people to serve the government in a wide range of offices; most important among them are ambassadors, members of the Supreme Court and federal courts and cabinet secretaries. However, more than 2 000 of these positions require approval by the Senate under the "advice and consent" provision of the Constitution. Congress holds the power to declare war but as Commander in Chief the President can send troops without declaration, or make an executive order, to undertake military action. Under executive privilege, the President decides whether or not information developed within the executive branch, may be released to Congress or the courts. The President is also authorised to propose new legislation, this however needs Congressional approval to become effective. Crucially, the President needs Congressional support to implement economic policies, and ultimately, the Supreme Court has the power to overrule any laws if they are deemed unconstitutional.

Very importantly, Trump will most likely have the support of a Republican Congress (Senate and House of Representatives). This does not mean that his political party fully supports his policy approach. Instead, he is going to have to work hard to unify his party, and will have to accept some compromises in getting his policy approved. This is not a new thing – many previous presidents have faced some of the same constraints, although usually from the opposition political party and not their own party. This may force some compromises on how economic policies are shaped.

Practically, all of this means that Trump has the executive power to do things like withdraw from the Trans-Pacific Partnership trade policy negotiations, restart exploration of the Keystone pipeline, sign executive orders deregulating energy prices and open trade cases against China, and much more.

Many of Trump's major economic promises will however require cooperation with Congress and/or Supreme Court approval. So, for example, repealing Obamacare, cutting taxes and building the infamous wall on the Mexican border would all require approval from Congress. More positively, Trump could focus on establishing a bipartisan agreement on a comprehensive infrastructural development package. Nevertheless many of the policy ramifications are still largely unknown, which could encourage business to adopt a "wait-and-see" approach when contemplating new fixed investment initiatives.

What does the election mean for economic policy?

A number of key economic policy issues were vigorously debated during the tumultuous election campaign. These included proposed changes in taxes, the extent of government spending, the need for additional trade restrictions, and the appropriateness of current monetary policy. Aligned to these areas of contestation were the US' policy on immigration and the government's foreign policy approach to China and Russia.

Trump proposes significant tax changes and increased government spending on infrastructure

One of Trump's main policy initiatives is to cut taxes, while simultaniously increasing government spending. He promised to 'at least double' Clinton's infrastructure spending proposal, implying at least 0.6% of GDP. He also talked about a 'trillion-dollar rebuilding programme', implying an expansionary fiscal policy.

Trump's original tax proposals were estimated to cost the government $10 trillion in lost revenue over 10 years, but later proposals suggested a much more modest and more realistic reduction, perhaps around $3 trillion or 1.6% of annual GDP. Strangely, Trump also talked about a balanced budget within eight years. According to his economic plan, this would come about as a result of a self-reinforcing growth stimulus, but in reality, achieving this seems highly doubtful.

Using a very simple debt model and assuming Trump got all his fiscal policy proposals approved (a somewhat unrealistic scenario); the US public net debt could increase to above 95% of GDP from about 75% currently. As a result, the US would probably lose the last two of its ‘AAA’ credit ratings.

In contrast, Clinton had focused on increasing middle-class incomes by cutting taxes within that income group. She proposed that these tax cuts could be partly funded by hiking taxes on high income earners, lowering the threshold for inheritance tax, and reducing the number of allowable deductions for corporate income tax payers that make it less advantageous for businesses to relocate overseas. She estimated that these tax changes would raise federal tax revenues by an estimated $1.1 trillion over 10 years, or about 0.6% of GDP each year. This is relatively modest and would have had only a modest impact on economic activity.

Given the backdrop of still relatively modest economic growth, it is possible that the government will look to fast-track planned increases in expenditure in order to stimulate economic growth.

Trade policy likely to become much more protectionist under Trump

One of Trump’s strongest arguments ahead of the election was that US jobs have been lost because of too generous trade deals with other countries, such as the North American Free Trade Agreement (NAFTA) and the TransPacific Partnership (TPP). He argued forcefully that unfair trade practices by other countries, especially China, are also harming US companies.

He wants to bring manufacturing jobs back to the US by embarking on a seven-point trade policy plan, namely:

- A withdrawal of the US from the TPP
- The appointment of tough US negotiators
- Identifying all trade agreement violations and seeking to end them
- Renegotiating the NAFTA to get ‘a lot better terms’ and, if not feasible, withdrawing from it
- Labelling China as a currency manipulator
- Bringing trade cases against China both in the US and the World Trade Organization
- If China does not cease these “unfair” trade practices, Trump would use clauses under various trade acts to remedy the disputes

In comparison, Clinton had stressed that she will ‘stop any trade deal that kills jobs or holds down wages’. She indicated that her administration would also say no to trade deals such as the TPP, which did not ‘meet her high standard of raising wages, creating good-paying jobs, and enhancing national security’. She also expressed scepticism about NAFTA, a trade deal negotiated by her husband when he was president.

Overall, it is clear that world trade has become much more protectionist since the Global Financial Market Crisis. This has led to a very noticeable slowdown in the growth of global trade, which has contributed to the current lacklustre economic growth.

There is a significant risk that if the clamour for increased trade protection gains momentum in the world's largest economy, the affected countries would most likely introduce retaliatory trade measures. This could set in motion a much more pronounced global trade war, which would be disastrous for South Africa given that more than 50% of South Africa's GDP is either imported or exported.

Trump does not support the current US monetary policy regime

The Trump victory is not good news for the US Federal Reserve. In particular, it now seems unlikely that Janet Yellen will be reappointed as Chairman of the Federal Reserve when her term ends in 2018 given Trump's view that the Federal Reserve has created 'a false stock market' and that Yellen is 'very political'. Initially, Trump supported the Federal Reserve's low interest rates policy. More strangely, Trump has supported a proposal to allow congressional auditors to review the Federal Reserve's decisions on interest rates. This would amount to extreme political interference.

It would be very unusual to replace the existing Chairman of the Federal Reserve during their term of office or even replace the Chairman when their term expires just because they represent a different political party. In fact, Barack Obama (a Democrat) reappointed Ben Bernanke as Chairman of the Federal Reserve despite him being a Republican. Equally, Bill Clinton (a Democrat) reappointed Alan Greenspan (a Republican) twice, while Republican Ronald Reagan kept Paul Volcker (a Democrat) as Chairman.

But Trump has excelled at doing the "unusual" and could certainly look to significantly change the composition of the Federal Reserve. Given Trump's more hawkish stance on monetary policy, he is likely to nominate a more hawkish Chairman of the Federal Reserve. Furthermore, he could also nominate more hawkish governors to the Federal Open Market Committee (FOMC). Not reappointing Yellen could create concerns that the Federal Reserve is no longer independent from Washington.

In contrast, it seems fair to argue that Clinton would, most likely, have re-appointed Yellen as the Chairman of the Federal Reserve in 2018, when her current term expires.

Trump offers a major shift in foreign policy, and will certainly tighten immigration controls

According to a wide variety of Trump's statements, US foreign policy could see a significant shift, creating a huge amount of political uncertainty around the world. There are a number of key shifts in foreign policy that could manifest over the coming years. These include an escalation of rhetoric towards China and increasing geopolitical pressure on North Korea (Trump has stated that China is the main enemy and not Russia). NATO members could be asked to contribute more to NATO if their contributions are below the 2% of GDP threshold. This could create possible frictions within NATO, at a time when Russia is flexing its military strength. Trump may also look to improve dialogue with Russia and strengthen economic ties with Cuba. He might also try to play a negotiator role in the Israeli/Palestinian deal while avoiding taking sides. More broadly in the Middle-East, he could encourage the US military to retreat from active rebel training, and look to act as a negotiator in the Syrian conflict, while letting Russia do the ground work. Lastly, one could expect more sanctions on Iran, but not necessarily more support of Israel.

In terms of immigration, Trump has argued, fairly forcefully, for a much more invasive approach to immigration, proposing the careful screening of each individual entering the country and the extreme vetting of immigrants from troubled parts of the world. In addition, he wants the temporary suspension of immigration entirely from regions where safe and adequate screening cannot occur.

In opposition, Clinton did not propose any major shift in US foreign policy, with China remaining a key strategic trade partner and Russia continuing to attract sanctions. She did highlight the need to reform immigration controls. In particular, she argued that immigration enforcement must be humane, targeted and effective.

Immigrants account for nearly 17% of the US total labour force, while Mexican immigrants account for 28% of total foreign born population. Many immigrants to the US end up working in manufacturing, transportation, construction and home services. In general, immigration leads to higher potential GDP growth as the labour force grows, more investments and a more efficient economy in terms of job matching.

Implications for South Africa are somewhat negative

The United States is one of South Africa’s largest trade partners (both in terms of imports and exports), and Trump made it clear in his campaign that he will look to review existing as well as proposed foreign trade agreements. The economic implications are potentially far-reaching and could ultimately undermine South Africa’s ability to export to the United States. In particular, the Trump presidency could also lead to a review of the African Growth and Opportunity Act (Agoa).

In terms of the direct foreign aid that South Africa receives form the United States; Trumps’ victory is likely to create some anxiety and uncertainty. According to the US Global Development Policy, South Africa continues to be an important strategic partner of the United States receiving around $269 million in foreign aid from the United States each year. While Obama and Clinton have generally been sympathetic to Africa, this approach could be reviewed by the new US administration.

It is also worthwhile to note that, on average, US economic growth under a Democratic president has been significantly higher than under a Republican president. An analysis of US GDP growth since Harry Truman was elected president in 1945 shows that the US economy has grown at an average of 4.1% under Democratic leadership, compared with 2.5% under Republican leadership. Part of this difference in growth performance relates to use of government debt to bolster economic activity. Unfortunately, Trump’s victory will lead to heightened policy uncertainty and possibly a “wait-and-see” approach by US companies when contemplating additional fixed investment spending. Presumably, the contentious issue of the US Debt Ceiling can now be much better managed. In the recent past, US Debt Ceiling standstills have been highly disruptive to financial markets and economic performance.

Looking at the performance of global financial markets in recent days, it is clear that most equity markets initially rallied on the growing expectation that Clinton would become the next US president. Those gains were then reversed when it became clear that Trump would win. This largely reflects a "heightened uncertainty" trade, rather than a fundamental change in the economic outlook of the US.

Bond yields moved higher ahead of the election due to a growing expectation that the Federal Reserve will raise interest rates in December and that consumer inflation is showing signs of moving higher. However, the election of Trump has reduced the likelihood that the Federal Reserve will raise interest rates in December and consequently bond yields have compressed modestly.

The Presidential election has also impacted currency markets. In particular, the dollar has weakened somewhat along with a range of emerging market currencies, while the so-called “safe-haven currencies” have benefited including the Euro and Swiss Franc.

Overall, though, it will take time for the markets to fully digest the impact of a Trump victory and to understand whether or not Trump’s extreme rhetoric will translate into actual economic and political policy or whether the institutional strength of the US will take the best of Trump’s suggestions in order to meaningfully lift economic growth.

At STANLIB, we recognise that we live in a world that is increasingly uncertain and understanding the connections leading to the volatility is crucial. Managing investments in this complex, connected world depends on being able to see and understand the bigger, inter-connected picture.

We will be paying careful attention to Trump’s suggestions ensuring that our customers benefit from more informed investment decisions.

Kind regards,

Kevin Lings
STANLIB Chief Economist