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Candriam Investors Group first comments on the US elections results and the Congress composition

As for the Brexit, the US elections delivered the result the markets and many political observers believed the less likely: Donald Trump has won the Presidency. As the Congress remains controlled by the Republicans, the US will now have an undivided government.

Donald Trump has clearly gained in credibility and the fact that, despite the reluctant support of many Republican leaders, he has won, may lead to a shift in the attitude of the Party: from now on, the President proposals may gain a lot more support from Congress than was expected.

This being said, there is a substantial amount of uncertainty about what a Trump Presidency will exactly mean for the US economy as well as for markets. It will take weeks and possibly months for this uncertainty to dissipate. In the meantime, markets will try to guess whether Trump will remain the wild populist of the campaign trail or will turn into a more pragmatic and realistic politician.

Some clues will be given in the coming days when we learn more about the composition of the future White House staff and also of course of the possible members of his cabinet.

1. What is Donald Trump's economic plan?

Anton Brender, Chef Economiste, & Florence Pisani, Directeur de la Recherche Economique

Donald Trump has a significant infrastructure plan
He has announced an infrastructure effort of $1 trillion over 10 years. According to the available information, this plan is meant to be deficit neutral: a tax credit would be offered to private companies to finance infrastructure projects and the companies would take the equity part of the projects ($167 billion of the $1 trillion would be equity investment, the rest being financed by debt raised by the private sector). This would imply that those new infrastructures would be privately held and run.
This could mean $100 billion of additional infrastructure spending per year over the next 10 years and should provide a one-off boost to domestic aggregate demand of +0.5% of GDP. Given the time lags, this support should show up mainly starting end of 2017.

On the fiscal side, Trump has advertised a huge “Reagan-type” fiscal stimulus.

He has promised to cut taxes by $4.4 trillion over 10 years. More specifically he has promised to reduce the number of personal income tax brackets from 7 to 3 (12%, 25% and 33%). This measure – the most costly one – would benefit mainly the wealthiest top 1%. But note that even if the amounts in play are smaller, other proposed measures would benefit a wider public, such as allowing for full deduction from taxes of the average cost of childcare, creating a tax free dependent care saving account for children or elderly relatives (low income households in particular would benefit from a $500 contribution to their saving account).

On top of those personal income tax cuts, Donald Trump is also committed to lower the corporate tax rate from 35% down to 15%, while at the same time closing some loopholes.

How is this tax cuts plan to be financed?

Donald Trump has presented his plan as being "deficit neutral":

- $1.8 trillion of receipts are supposed to be generated by higher growth due to the tax cuts themselves.
- Another $1.8 trillion should come from the additional boost to growth provided by the rest of its economic plan (infrastructure investment effort, energy and trade-related measures…).
- On the spending side, $0.8 trillion of public money should be saved thanks to the so-called "penny plan" : i.e. a yearly cut in non-defense discretionary spending of 1 cent per dollar spent.

For this tax plan to be deficit neutral, not only should the Penny plan be effectively implemented (which is not that easy!) but the rate of growth of the economy will have to average 3.5% over the next 10 years. This seems very difficult to achieve unless there is a huge reversal in the trends of both the participation rate and productivity (those interested in the numbers can look for more details on our internet website).

The question of course is whether after Donald Trumps' victory, Congress will remain as fiscally conservative as it has been. If yes, it is unlikely to agree on the "full-sized" Trump fiscal plan since this would be taking the risk of a significant deterioration of the Budget balance over the coming decade. If Congress shifts to a less conservative stance, this could lead to a Reagan-type policy… and a Reagan-type increase in the public deficit.

What will happen with Donald Trumps' other proposals is uncertain.

Remember Donald Trump has promised to act during the first 100 days of his Presidency both on the trade and immigration front.

- On immigration, the measures he has proposed have been widely commented. We believe Congress is still unlikely to endorse most of them, the more so since they may be opposed by many business lobbies.

- The international trade issue may be the most serious one since here the President seems to have a rather "free hand": according to many international trade' specialists, the President could for instance, on his own, take the US out of NAFTA with just a 6-month notice! Without going that far, the temptation to quickly take some visible measures on trade may be high as this would be the easiest way to show that he is delivering on what he has promised.

2. What about our macro scenario?

Anton Brender, Chef Economiste, & Florence Pisani, Directeur de la Recherche Economique

We obviously will have to refine (or even revise!) our 2017 forecast.

On one hand, many firms will be confronted with a new environment: in the coming months uncertainty on trade and immigration policies could hinder equipment investment in many sectors.

On the other hand, this drag on equipment investment could be offset by the stimulative effect of the other measures. Deregulation in the energy sector could trigger some new investments in the shale oil industry. At the same time, the infrastructure effort could also provide some support. And remember Donald Trump has also promised more public money would be spent for defence and Veterans.

Clearly there is some upside risks to our baseline scenario… but political and markets' turbulences could also come into play. So, for the moment, and until we see you all at our next roadshow, we keep our 2% growth forecast for the US economy in 2017.

3. What about the Fed?

Anton Brender, Chef Economiste, & Florence Pisani, Directeur de la Recherche Economique

In this new environment and after the tough talk that took place during the Campaign, the Fed and notably its President Janet Yellen, will be under particular scrutiny. Two Board of Governors seats are vacant and, with the approval of Congress, could quickly be filled. Moreover Congress could be tempted to exert an unwelcome pressure on the Fed, insisting on more "transparency" in its decision-taking process (the so called "Audit of the Fed" initiative).

We believe that confronted with a less friendly political environment, the Fed would continue to stick to its mandate and do its best to keep the economy running at its potential.

4. Global asset class impact: more uncertainties

Nadège Dufossé, Responsable Allocation d'Actifs

The election of Donald Trump as 45th US President takes financial markets off-guard. It means more uncertainties that could hurt emerging markets and trade-sensitive assets… We expect more market volatility in the coming weeks. The medium-term uncertainty due to Donald Trump's unpredictable personality will depend whether a populist or a pragmatic Donald Trump ultimately shows up.

Donald Trump will have a Republican majority in Congress but majority does not imply control. President Trump will need to work on policy compromises with his majority if he wants to implement his massive infrastructure investment and fiscal easing plans.

Last night's election outcome has actually added policy uncertainty as the risk of a material trade conflict and a likely worsening of the US' trade relations are starting to be discounted. The short term uncertainty translates in a more volatile environment where emerging markets and trade-sensitive assets could be hit. US equities could do better in that context. Donald Trump's pro-business agenda is at odds with a risk-off market reaction and positive post-Brexit market reactions remain in fresh memories.

US bond yields seen higher even if December Fed hike is further delayed

Any decline in US bond yields could be short lived as it would not be consistent with fundamentals. A longer term rise in US bond yields could occur due to the expected widening of the fiscal deficit over the medium term and, ultimately, a more aggressive Federal Reserve reaction function. A short-term too strong risk-off reaction could nevertheless prevent the Federal Reserve to hike its Funds rate in December.

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