

11 Oct 2024

Jahnvi Prabhakar
Economist

Trumponomics

A sweeping victory has brought back Donald Trump to the White House for the second time. There are a range of intentions made during the election campaign and the victory of the President-Elect will have implications on issues ranging from immigration to growth and inflation. These policies are part of the 'America first' agenda. This note attempts to take a quick look at these core issues and their impact on US economy and their implications for India.

US economy remains resilient, growing at a solid pace with a strong growth of 2.8% registered in Q3CY24 on the back of the uptick in consumer spending. PCE inflation have cooled off to 1.5% in Q3 compared with 2.5% in Q2 and is lower than the Fed's target mark of 2%.

So where is growth and inflation headed?

In order to boost the economy, President Trump has proposed lowering of taxes, specifically the corporate tax down from 21% to 15%. The tax cuts enacted back in 2017 during his first tenure could also possibly become permanent. Furthermore, the President-elect has suggested to bring back the unlimited itemized deduction for SALT (state and local taxes). Additionally, there are plans of exempting taxes on social security payment, overtime pay and provide interest deduction on auto loans.

On tariff, it has been proposed to levy 60% to 100% on products from China and a tariff of 10% to 20% will be levied on goods from rest of the world. Moreover, he has proposed to even revoke the trade status of Most Favored Nation given to China by steadily phasing out imports on essential goods from China and restricting China from purchasing any land in US. This could result in resurfacing of the US-Sino tensions.

US economy at the current juncture has been performing well with robust growth and lower unemployment level. The proposed tax cuts would result in higher demand, while the higher tariff will turn out to be inflationary. He has suggested different measures to 'defeat' inflation, including lowering the oil prices by allowing companies to drill in a lot more places and push for speedy production. Overall, such policies will strengthen dollar, push bond yield higher given the expansionary fiscal measures and could even drive capital inflows.

The inflationary measures can put a break to the Fed's easing cycle. The Central Bank has already cut rates by 75bps since the beginning of the cycle. President-elect had suggested the Federal Reserve should also be subjected to more presidential powers though there are no details offered on the same. Some experts expect the proposed protectionist measures could push the economy in to 'overheating', pause the rate cut and result in greater volatility in financial market.

On immigration, the president-elect has stated about mass deportation of illegal migrants and this too is likely to have an inflationary impact as wages would tend to rise leading to demand pull forces.

Impact on Budget

Given the pro-growth measures, there is a growing concern that policies such as tax cuts will add to the expanding budget deficit and could possibly become unaffordable in a span of next decade. The current national debt has ballooned to 122% of GDP and expected to grow further. As per some experts, the broader impact of these policies could result in raising the deficit by US\$ 4.1 tn. The President-elect has suggested the rising budget deficit can be managed through tariff imposition. According to analysts, a 20% levy could possibly add US\$ 3tn which will fall short of offsetting revenue loss in case the tax cuts are made permanent.

What's in store for India?

- Given the proposed protectionist measures could escalate tension between US-China, India most likely could benefit from this shift in power through emergence of new opportunities and benefit from the supply chain diversification.
- However, caution needs to be exercised as a stronger dollar will result in expensive imports but supported by stronger exports for India.
- Since there is uncertainty in terms of how the US debt will be managed, it will cause volatility in the global markets.
- Volatility in bond and forex markets may be expected in light of this bouquet of policies that could be implemented in the USA.

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For further details about this publication, please contact:

Economics Research Department
Bank of Baroda
chief.economist@bankofbaroda.com