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US Watch

Group Economics
Macro & Financial Markets Research

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Clinton vs Trump

- **A Democratic victory seems likely in November's presidential elections**
- **We don't think that the outcome of the elections will substantially change the US economy in the coming years**
- **A divided government with a Democratic President and a Republican majority in the House and possibly in the Senate, will make large policy shifts more difficult**
- **Although we expect policies to be toned down once in office, both candidates want to increase government spending. But Mr Trump would combine it with corporate tax cuts, resulting in a large increase in debt**
- **As for the US dollar, political developments have less of an impact, instead the growth/inflation mix and real interest rates play a larger role**
- **Despite political uncertainty, we expect USD safe haven flows to remain low**

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With the US presidential elections heating up, we ask what impact the nomination of President Clinton or President Trump may have on the economic landscape. Although the economic agendas of Hillary Clinton and Donald Trump are not specific enough to make reasonable quantifications, we have tried to compare the major issues in both agendas and what the political constellation (majority in House and/or Senate) would mean for the implementation of these policies. Our base case scenario focuses on a divided government, with a Democratic administration, but where the House and possibly the Senate having a Republican majority. This will likely result in recurrent episodes of political uncertainty given the rising polarisation, making transformations more difficult. However, in light of the common ground in some major issues, including infrastructure spending, we think that some progress will be made on these fronts.

Hillary likely to go to Washington

Early November the US will hold presidential elections, as well as elections for the House of Representatives and for the Senate. Ahead of July's National Conventions, Hillary Clinton has been comfortably leading most polls by a decent margin (4 ppts). In the past, the accuracy of election polls has been dependent on how close a call the results are. Overall, it therefore seems more likely that the Democratic candidate will win the presidential elections, but that the Republicans will continue to hold majorities in the House, since the Democrats are short 30 seats to becoming a majority, while Republicans are only short 5 seats. It is therefore unlikely that Democrats will control the House. The outcome of the Senate is more difficult to predict.

The economic debate has fallen to the background in these elections…

This time the US election process has surprised many by the anti-establishment bias. Presidential candidates, including Mr. Trump, have banked on the anti-globalisation and anti-migration sentiment, inequality and the desire to defend national self-interests. In fact, during the campaign the economic agenda has fallen to the background and instead communication has notably drawn on fear, trying to attract voters that are sceptical about globalisation.

…while economic agendas remain vague

The economic agenda of Donald Trump outlines few concrete views, while Hillary Clinton's approach sets 37 priorities/issues, but remains vague in many aspects. Both candidates share to some extent the views on blocking or rolling back free trade agreements and increasing government spending (see table below). But Mr Trump has stronger convictions. He categorically rejects trade deals and has promised to take a more aggressive approach against China and Mexico to balance trade relationships. These policies could lead to isolationism as countries would likely retaliate. US export growth would most likely shrink. The largest policy differences are related to migration and healthcare policy. Mrs Clinton represents continuity with the Obama administration on these issues, while Mr Trump plans to reduce immigration, including building a wall with Mexico. This type of immigration policies would tighten the labour market as the labour force contracts. With the economy nearing full employment, labour shortages could have a large impact on wages and eventually lead to less employment.

As for government spending, both candidates are likely to increase government spending. However, Mr Trump significantly so. Mrs Clinton prioritises health care and social security, which is mostly offset by new revenue. Meanwhile, Mr Trump wants to bring corporate taxes down to 15% from 35%, while Mrs Clinton proposes to pay for new spending with income tax increases primarily on high income tax payers. The Committee for a Responsible Federal Budget has estimated that the total budgetary impact from Trumps proposal would mean an increase of debt/GDP ratio by 52 ppts by 2026, while under Mrs Clintons plans debt/GDP would increase by 12 ppts. We think that Trump's significant debt increase is not viable. It would face resistance even within the Republican Party since US debt/GDP would become unsustainable (120%).

Economic agenda Clinton vs Trump

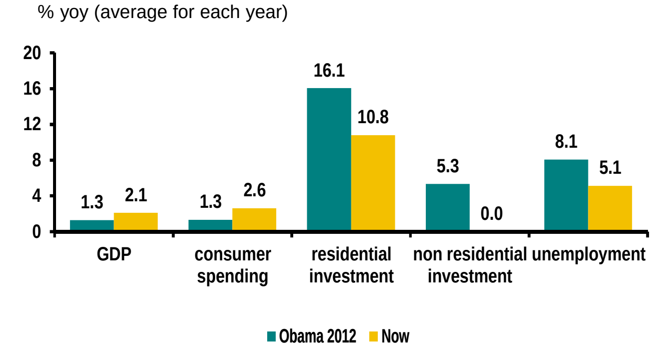
	Clinton	Trump	Major differences
Reject TPP	Y	Y	Clinton: details unclear Trump: proposes declaring China a currency manipulator and plans to impose duties on China imports
Renegotiate NAFTA	Y	Y	Similar views, but details unclear
Limit migration	N	Y	Clinton: path to citizenship Trump: build wall and pause immigration work visas
Increase defence spending	N	Y	Clinton: defeating ISIS, holding China accountable, standing up to Putin through partnerships Trump: Significant increase in defence spending to make military the most powerful
Increase infrastructure spending	Y	Y	Clinton: boost spending USD 275 billion (1.5% of GDP) in next five years and revive Build America Bonds, financed through business tax reform Trump: supports substantial but unspecified spending
Increase R&D spending	Y	N	Clinton: proposes increasing funding for the National Institutes of Health (NIH) and National Science Foundation Trump: has said more concerned about foreign threats than about R&D
Repeal affordable care act	N	Y	Clinton: increase subsidies ACA and allow 55 and over to buy into medicare Trump: repeal ACA
Decreases corporate tax	N	Y	Clinton: no specific tax proposal, limit earning stripping via interest deductions, raise ownership threshold to 50% to qualify for expatriation Trump: reduce corporate tax and pass-through income to 15%, 10% tax accumulated untaxed foreign profits, tax multinational foreign income
Increase individual tax rates	Y	N	Clinton: 4% surtax income over USD 5 mn 30% minimum tax on taxpayers with income greater than USD 1 million Trump: 4 tax brackets, 0%, 10%, 20% and 25%. The top applies for incomes > USD 150,000 single and 300,000 double filers.
Increase minimum wages	Y	N	Clinton: raise federal minimum wage to USD 12 per hour Trump: no mention

Y= yes N= no
Source: Hillary Clinton and Donald Trump economic agendas and press, ABN AMRO Group Economics

Republicans and Democrat voters pessimistic on the US economy

Although the US economy is showing some improvement, US voters are sceptical about the future. If we look at the economy in 2012 when Obama II came into office, it was in a n weaker condition than it is now. However, there is more uncertainty now regarding the economic outlook.

Economy better off than in previous elections



Source: Thomson Reuters Datastream, ABN AMRO Group Economics

Indeed, the scepticism about the economic outlook is larger for Republican supporters than for Democrat supporters, but in both cases sentiment is deteriorating. According to surveys conducted by YouGov, since mid-2015 less than 10% of Republican voters think that the economy is getting better. Democrat voters are more positive about the economy, but still only around 30% think it will get better. However, they have become more negative since one year ago, when around 50% thought the economy was getting better. These differences explain the scale of the transformation that is being proposed for the economy. Indeed, the Republican candidate is looking for an overhaul of a broad range of issues, including tax reforms, migration, trade and national security.

Possible scenarios for government set-up

Given the political constellation in the House and in the Senate, we think that a divided government will be the most likely outcome. We sketch two more likely scenarios and a low probability scenario. In the first two scenarios, Hillary Clinton is President and in the last Donald Trump is President. The variants in the first and second scenarios relate to the majority in the House and in the Senate.

I. Democrat President, Republican majority in House, Democratic majority in Senate

We think that under this scenario (most likely), policy transformation will be difficult. Still the polices that are to some extent supported by both parties, including boosting infrastructure and defence spending will likely be implemented. We think that overall the policy proposals will not have a major impact on economic activity. The economy will continue to grow at moderate levels and inflation will be moving towards the 2% target. Under this scenario debt/GDP will likely increase somewhat since the economy will not be able to reach the debt targets simply by growing.

II. Democrat President, Republican majority in House, Republican majority in Senate

Under this scenario (next to most likely), Republicans have the majority in the House and Senate. The potential for policy transformation is even more limited. We see this scenario as more fragile, with higher political risks. Under this scenario, for instance increasing individual tax rates and health care related reforms will be more difficult to achieve, while migration policy will also be difficult to reconcile. Here there would be more political stalemate and uncertainty. The economy could be under pressure until both parties reach compromise. In this scenario, economic growth will be weaker, but it is difficult to quantify extent given vague policy details.

III. Republican President, Republican majority in House, Republican majority in Senate

This is a low probability scenario. We think that the proposals made by Mr. Trump will be toned down once he is in office. In general, as already mentioned, after elections the position of the incoming President is much more nuanced. However, we think that the political risks resulting from uncertainty will be high under this scenario. The US economy would be more isolated and trade growth would decline. Meanwhile foreign direct investment would likely be hurt. Requiring undocumented migrants to leave the US would likely raise social tensions as well. In this scenario economic growth would be considerably weak and inflation pressures could increase, as growth potential falls. The debt/GDP ratio would increase significantly. The transformation proposed would cause significant uncertainty, which would also weigh on the economy.

How did the US dollar behave during previous Presidencies?

Our research suggests that economic developments and sentiment in financial market have a larger impact on the US dollar than political developments. The US dollar has a very specific character. The US dollar is at times a cyclical currency and at times a safe haven currency. This means that at some times cyclical drivers dominate and set the trend for the US dollar, while at other times its safe haven characteristics prevail. It is crucially important what drivers dominate in what environment. Below there is an overview of how the US dollar behaved during past presidencies.

US dollar during previous Presidencies

Presidency	Developments during Presidency	US dollar
Ford	Above 4% growth, good growth/inflation mix, increase in real yields (not positive though)	2.0%
Carter	Sharp growth slowdown, negative growth/inflation mix, higher and positive real yields	-13.0%
Reagan I	Above 5% growth, good growth/inflation mix, real yields high and coming off	68.0%
Reagan II	Slowing economic growth, negative growth/inflation mix, no change in real yields (high levels)	-39.0%
G Bush	Growth pick-up, good growth/inflation mix, sharp drop in real yields (to zero)	-0.2%
Clinton I	Some growth pick-up to 4.5%, weaker growth/inflation mix, higher real yields	-4.2%
Clinton II	Growth slowdown, EM crisis, weaker growth/inflation mix, higher real yields	21.4%
GW Bush I	Some growth pick-up, higher growth/inflation mix, sharp drop in real yields to negative	-28.7%
GW Bush II	Sharp drop in growth, GFC, negative growth/inflation mix, positive real yields again	0.5%
Obama I	Sharp improvement in growth and growth/inflation mix, eurozone crisis, sharp drop in real yields again to -1.5%	-1.5%
Obama II	Improvement in growth and growth/inflation mix, EM & Commo crisis, improvement in real yields	16.4%

GFC – global financial crisis
Source: ABN AMRO Group Economics, Bloomberg

The most positive combination for the US dollar would be above trend economic growth, improving growth momentum, positive growth inflation mix (meaning growth is above inflation) and rising or high real yields (official interest rate - inflation). This would be a cyclical driven US dollar. Only the Presidency of Reagan I showed this unique supportive combination, while Reagan II was the opposite for the US dollar. What is more, when Reagan became president in 1981 he was able to increase the America's self-esteem/moral. As a result, the US was seen a strong global power and this also gave a strong support to the US dollar. Often the cyclical drivers are not all pointing in the same direction, so their impact could be more neutral. The US dollar could also be in high demand as a safe haven during a major crisis. The US dollar rallied sharply during Clinton II because of the various crises (Asia FX, LTCM, Russia, LatAm) and Obama II because of EM FX crisis and sharp drop in commodity prices. In both Presidencies there have also been supportive factors from the cyclical/fundamental side.

How will the US dollar behave going forward?
Our forecast horizon does not cover the four years of the upcoming Presidency. Our forecasts cover up to the end of 2017. Our base scenario suggests that US economic growth will remain below trend, improving only slightly in 2017. The growth/inflation mix is not supportive with inflation expected to be above growth. Meanwhile, real interest rates are forecast to remain negative (less negative though). Overall, this is not a supportive combination for the US dollar. If this trend were to continue, it is unlikely that the US dollar will rally due to cyclical drivers.

Not a US dollar supportive combination

Our forecasts

Upcoming Presidency	01/01/2017	31/12/2017	Change
Economy	1.7	1.8	0.1
Fiscal balance as % of GDP	-2.4	-2.4	0.0
Current account balance as % of GDP	-2.6	-2.7	-0.1
Monetary policy	0.5	1.3	0.8
Inflation y-o-y	1.4	1.9	0.5
Growth/inflation	1.2	0.9	-0.3
Real interest rates (official rate - inflation)	-0.9	-0.7	0.3

Source: ABN AMRO Group Economics

The question remains if the US dollar will rally because of safe haven demand during a major crisis. In the recent years we have experienced EM FX crisis, sharp commodity sell-off and UK vote to leave the EU. Going forward we expect uncertain financial markets, but not a new major crisis in the making. As a result, safe haven flows towards the US dollar will likely be low. These developments are in a context of a long-term US dollar trend that has turned negative. However, if there were to erupt another major crisis, the US dollar could rally substantially on safe haven demand. If Trump were to become President (low probability in our view), the US dollar will probably weaken over time. This is because we expect that his policies will be inward looking and will weaken the fundamentals of the US economy.

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