Underlying Trends
President TRUMP
Three scenarios for the US economy

DIDIER BOROWSKI, *Research, Strategy & Analysis*

In all likelihood, President Trump will not keep all of the promises he made as a candidate. On many subjects, the President-elect already seems to be backtracking (wall between Mexico and the United States, expulsion of immigrants). Of course, the President does have a majority in Congress, but the majority in the Senate (one seat out of 100) is too small to allow the President to dispense with moderates, who are deeply hostile to any budgetary drift (unless the economy slows down significantly). **Under these circumstances, there is deep uncertainty over the policy that will *actually* be implemented**. **It will most likely be several months before we have a clear vision of the new administration's main priorities. We can discern three scenarios.**

Downside risk scenario (15%)

The President is exactly what he promised to be as a candidate. There is a long list of downside factors:

- Protectionist measures: customs barriers, challenges to trade agreements, confrontation with China (exchange rate). Retaliation against partners (global trade shock, currency war).
- Withdrawal from NATO, isolationism, rejection of the Paris climate agreement.
- Expulsion of immigrants and tensions with neighbouring countries (especially Mexico).
- Loss of the United States' credibility on the world stage, or even domestically.
- From a fiscal perspective: tax cuts focus on high-income earners and are entirely financed by cuts to social spending (healthcare, education, etc.). The negative effect of these cuts to spending outweighs the positive effect of tax reductions (the wealthy have a lower marginal propensity to consume).

Growth plunges. The risk of recession re-emerges.

Upside scenario (15%)

The "candidate as maverick" gives way to a moderate president who consequently surrounds himself with advisors.

- Donald Trump renounces protectionist measures and moderates his position on controversial topics (immigration, trade).
- From a fiscal perspective, the president convinces his majority to launch a "real" stimulus plan (i.e., with a significant increase in the budget deficit). Cuts to taxes and infrastructure spending are passed at the same time, along with a possible increase in the federal minimum wage (in order to gain some democratic votes). The stimulus lasts several years. Most of the spending adjustments are postponed. The deficit increases significantly (from 1.5% to 2% of GDP). Budget and fiscal multipliers are exploited to the full. Growth and inflation (2018-2019) are revised upward substantially: GDP growth is between 2.5% and 3% of GDP in 2018, after 2% growth in 2017. The Fed supports the reflationary trend by hiking its key interest rates throughout 2017.

Central scenario (70%)

The White House and Congress come to a compromise, with concessions on both sides. A modest fiscal stimulus plan is passed in the first half of 2017. Priority is given to tax relief, a topic on which all Republicans agree. Tax cuts are revised downward and focus more on the middle class. Spending cuts are spread out over several years to minimise the shock on business and preserve the stimulus effect of short-term fiscal policy. The budgetary cost of infrastructure spending is contained by prioritising the financing of public/private partnerships. As they take a long time to implement, they have little impact on growth in 2017-2018.

The budget deficit grows slightly (+0.7% of GDP, i.e., $130bn) in 2017-2018. The risk of recession falls significantly. Without a fiscal plan, we estimate that US growth will slow down in 2018 (1.6%). Growth stabilises and even accelerates slightly in 2018 (from 2% to 2.2%). This stimulus helps extend the cycle by maintaining the rate of expansion at its average from the 2009-2016 period, or slightly higher. However, at the end of the cycle (full employment) wages and underlying inflation accelerate significantly. Monetary conditions tighten (increase in long-term interest rates and the dollar). The Fed is maintaining its monetary gradualism (three interest rate hikes over the next 12 months).

At this stage, we believe that the downside and upside risks will neutralise each other. If growth stabilises around 2%, it is unlikely that fiscal policy will be as proactive as is currently assumed. However, the threat of recession would increase the chances of a stimulus plan as described in the upside scenario. Ultimately, fiscal policy must be more reactive than proactive.

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Contributors

AMELI-RENANI ABBAS, *EMG Debt Strategy – London*
AINOUZ VALENTINE, *Credit Strategy – Paris*
BERTONCINI SERGIO, *Credit Strategy – Milan*
DE BRAY YASMINE, *Equity Research – Paris*
BUTLER RICHARD, *Credit Research – Paris*
BOROWSKI DIDIER, *Economic Research – Paris*
DRUT BASTIEN, *FX and Fixed Income Strategy – Paris*
FORTES ROBERTA, *Strategy and Economic Research – Paris*
GEORGES DELPHINE, *Multi-Asset Strategy – Paris*
HERVÉ KARINE, *Economic Research – Paris*
ITHURBIDE PHILIPPE, *Global Head of Research – Paris*
JI MO, *Economic Research – Hong Kong*
LAPEYRE THOMAS, *Equity Research – Paris*
LETORT VALÉRIE, *FX and Fixed Income Strategy – Paris*
MARTIN EMMANUEL, *Equity Research – Paris*
MIJOT ÉRIC, *Equity Strategy – Paris*
PARET ANNE-CHARLOTTE, *Strategy and Economic Research – Paris*
PERRIER TRISTAN, *Economic Research – Paris*
WANE IBRA, *Equity Strategy – Paris*
YOSHINO AKIO, *Economic Research – Tokyo*

Editor

ITHURBIDE PHILIPPE, *Global Head of Research – Paris*

Deputy-Editors

BOROWSKI DIDIER, *Economic Research – Paris*
BUTLER RICHARD, *Credit Research – Paris*
MIJOT ÉRIC, *Equity Strategy – Paris*
JI MO, *Economic Research – Hong Kong*
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Conception & production

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