Mizuho Market Comment

11 March, 2024

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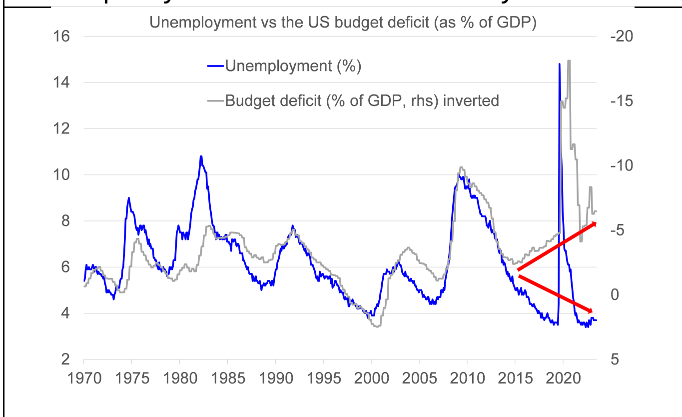
Thoughts on what a Trump presidency might mean for financial markets

- **For now, our base case is that Trump becomes president and the Republicans sweep Congress…**
- **This is likely to see fiscal policy loosen even further and the deficit rise**
- **This will limit scope for Fed cuts in 2025. Yet the UST curve may steepen**
- **Initially such a backdrop is likely to be positive for the US dollar**

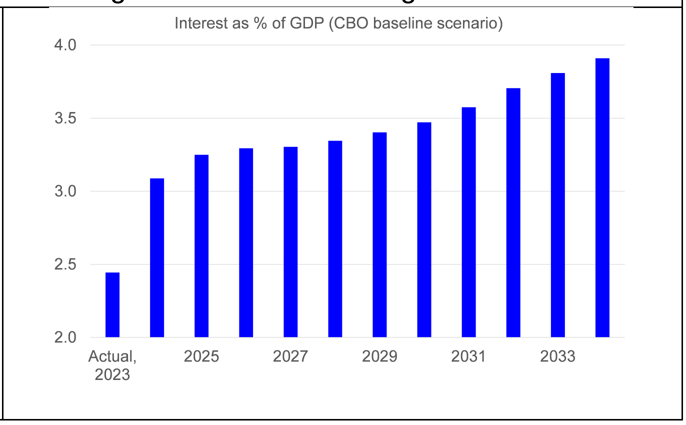
Plenty of unknows ahead of the November US elections, but Trump/the Republicans are the favourites
Forecasts for financial market developments 12 months hence will include the first two months of the next US presidency. Our base case is that Donald Trump will be the next president. The polls suggest he is the favourite. His legal problems are a potential hurdle but we assume that the consensus forecast includes these being resolved in his favour. He has had some minor victories on this front so far this year and the timings of his upcoming trials remain uncertain. We also assume a Republican sweep of Congress. They already hold a narrow majority in the House and it is usual for the House to swing in the same direction as the Presidency. The Republicans are also the favourite in the Senate, where the Democrats are defending a large number of the seats being contested. (Only 1/3 the 100 senate seats are contested every 2 years, plus special elections of which there are 2 this time round. So, Democrats are defending 23 of 33 regular seats and 1 of the 2 special elections). It will be hard for the Democrats to flip any Republican seats, so they need to retain all their own seats to retain a majority (and assume that they win the presidency to resolve ties in their favour). This looks hard given that Virginia senator Manchin is retiring. Virginia is a solid Republican state and its senate seat will likely line up in the Republican column from 2025. We hold the above views loosely. There is a long way to go before November and other than in his initial election campaign for the presidency in 2016, the Republicans have tended to underperform under Trump. His fund raising looks a little anaemic this time round too. In addition, it is possible that the Democrats finally gain some traction in the polls as inflation declines and the labour market remains firm. The economic backdrop should favour the Democrats more than it seems to be doing. Furthermore, Trump's legal woes remain a wildcard. .

Fiscal loosening more likely than fiscal tightening
Trump made no progress on shrinking the deficit in 2017~2020. Indeed, the deficit expended sharply. We expect more of the same. The deficit's link to the economic cycle broke down early in the Trump presidency. Our US colleagues see the deficit potentially rising as much as $200bn/year, with the bulk of the increase centring around the expiry of the 2018 Tax cuts and Jobs Act. At least some of the tax cuts, which are currently scheduled to expire in 2025, will be made permanent. We assume this will just raise the deficit, as we expect only limited spending cuts at the same time. We suspect that defence will also be heavily funded and expect that revenues from tariffs will be modest. The deficit is likely to rise – it is just a question of how much.

Fiscal policy has detached from the cycle…



…leaving interest costs building



Source: Bloomberg, CBO

On monetary policy we expect more of the same

Trump is less likely to respect central bank independence relative to other occupants of the White House. This was the case last time he was President. While monetary policy is supposedly independent of government, the government does control appointments. Although Trump appointed Powell as Chair to replace Yellen in 2018, last month Trump accused Powell of considering rate cuts to help the Democrats and said that he would not re-appoint him as Chair when his current 4-year term (as Chair) runs out in May 2026. Beyond nominating a new Chair, there are limited opportunities to influence policy via appointments as few of the Fed's Board members are up for replacement in the next 4 years.

It's a little unusual for Trump to be complaining about rates being lowered or being too low. Generally, given his real estate background, we see him as generally seeing rates as too high. Indeed, in his previous term as President he clashed with Powell urging him to lower rates. Nonetheless, we still expect Trump not to show much respect for the notion of central bank independence, especially where he sees electoral advantage in doing so. We do not expect the Fed to accede to such pressure and as such the market impact should be limited. However, such pressure would continue to erode the institutional fabric of the country at a time when the Fed will potentially be under pressure from elevated inflation. In general, attacks on the Fed's independence against a backdrop of potentially elevated inflation seem likely to support a mild curve steepening bias.

Looser fiscal policy will likely mean tighter than expected monetary policy

In our monthly forecast publication (https://www.mizuhogroup.com/emea/what-we-do/insights-and-research/insights) we boosted our US 2025 GDP and inflation forecasts to take looser fiscal policy into account. With the output gap likely already positive, any additional stimulus is mainly inflationary. We see a reasonable chance that US inflation fails to come down and stay down, which limits the room for rate cuts from the Fed. Even as we expect other G10 central banks to be clearly still easing in early 2025, the case for on-going Fed easing will be much less compelling. Tighter Fed policy limits the down side for front-end yields, while concerns over fiscal policy imply a steeper curve. We suspect that at least initially, this will prove positive for the US dollar as the initial focus is on nominal yields spreads vs other currencies, rather than real rate spreads. As such we have pushed up our end Q1 25 USD forecasts a little.