US Macroeconomics

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Five Pillars of Trumponomics 2.0

The proposed economic policies by the incoming Trump Administration should lead to faster non-inflationary growth relative to the economy's recent performance.

However, there is a danger the Fed keeps rates elevated if policymakers misdiagnose President Trump's policies as being demand side stimulative instead of the supply-side growth positive initiatives that they are. The risk of a 2025 monetary policy error is high.

The five basic pillars of Trumponomics are the implementation of tariffs, the extension of corporate and individual tax cuts, abundant and inexpensive energy, significantly less government regulation, and streamlined approach to government expenditures. These components of Trumponomics are designed to be implemented simultaneously thereby producing maximal positive economic effects.

This integrated approach works as follows: The implementation of tariffs is designed to discourage domestic firms from outsourcing or offshoring production. If they leave, they will be tariffed. At the same time, foreign producers who would now have to pay tariffs are incentivized to relocate their production to the US.

Domestic producers' decision to stay and foreign producers' decision to onshore will be further incentivized by the persistence of low corporate tax rates, cheap energy, and less onerous anti-business regulation. This will provide an optimal environment for supply-side industrial-led growth.

Additionally, the extension of the 2017 Tax Cuts and Jobs Act (TCJA) and a further reduction in the corporate tax from 21% to 15% will lift business uncertainty and further galvanize capital formation, the key ingredient to productivity gains and higher living standards.

Consequently, the current policy framework should allow the US economy to expand 3% next year but with a better mix in growth. The economy will get more capital spending which should increase potential output and less government spending which will free up scarce resources. There should be a step-up in the private sector activity.

While our 2025 projections assume headline and core inflation will slow close to the Fed's 2% target by year-end, we are concerned monetary policymakers may have a different view. We worry they may stop easing monetary policy early next year because they mistakenly believe the prospect of faster growth keeps inflation sticky. If so, the Fed would take a "wait and see" with respect to the economic outlook.

In fact, uncertainty around the Fed's policy response to the incoming Administration's legislative actions is potentially the biggest known risk in 2025. As our work has repeatedly shown, US consumer borrowing is hovering close to a two-decade high so ultimately official interest rates need to decline.

To be sure, lower energy costs and increased productive capacity will dampen price pressures. Moreover, an increase in tariffs is not inflationary because it is a one-off adjustment to the price level but we also need to account for the fact that foreign producers may absorb the bulk of the tariff effect. And if oil and gas prices decline as we expect, measured inflation should continue to slow. Remember that the energy sector has a larger weight in the economy than the share of imports.

With respect to our 2025 real GDP and interest rate forecasts, output is projected at a solid 3% but with a much better mix in output of more capital investment and less government spending. Long term interest rates should fall to around 4%.

Near-term, financial market participants need to grapple with weakening job momentum and sticky inflation, a troublesome mix for the Fed. Chair Powell recently said he is not in a hurry to cut rates, and an expected rebound in November employment is likely to stay the Fed's hand on December 18. But we expect monetary policymakers to re-engage on their easing course next year, fearful that it will not get extended far enough into the year. Stay tuned.

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