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December 12, 2016

November 8 provided the biggest electoral surprise since Brexit, and as with Brexit, markets have reacted with whiplash.

As Donald Trump's poll numbers slowly climbed in the two weeks prior to the election, the S&P 500 experienced a nine day sell-off—longer than any experienced during the darkest days of the financial crisis and the longest since 1980. On the evening of election day, as it was dawning on the world that Trump might actually win, S&P 500 futures began to plunge. By 9:30pm PST, they were down five percent from the close just a few hours earlier and futures trading was halted.

Yet, at the next morning's opening, after the election outcome was clear, markets began to snap back. By the end of the first day of post-election trading, the S&P was eight points higher. And this was just the beginning of a month-long rise. As of this writing, the S&P is up 5.6 percent from the pre-election close, an increase of over one trillion dollars in total market cap. The S&P 500 currently stands at all time high.

Markets seem to have registered two very different verdicts within just a few days. If all of this leaves you with a sore neck, or at least a little dizzy, we can certainly understand. Economists, as a group, have not made the situation any easier to grapple with.

Prior to the election, 370 economists, including eight Noble laureates, signed an open letter published in the Wall Street Journal, which proclaims, "If elected, [Donald Trump] poses a unique danger to the functioning of democratic and economic institutions, and to the prosperity of the country."

Yet beginning the morning after the election, economists generally began to sing a more upbeat tune. Within weeks of the election, the Wall Street Journal's consensus forecast of future economic growth was revised upward. Their survey of economists noted that "proposals to reduce taxes and invest in infrastructure will amount to a substantial fiscal stimulus." Even Trump detractor Paul Krugman offered, "Don't be surprised if economic growth actually accelerates for a couple of years."

In contrast, just three months ago, the CERF team wrote, "Our forecast is pretty much the same as it's been for years, anemic economic growth as far as we can see. Either Trump or Clinton will be president, but which one is president doesn't matter for our forecast, because neither has a program that will generate the promised growth."

It should come as no surprise that here we are, post-election, to proclaim that our forecast is pretty much the same as it was before, slow growth as far as we can see.

Underpinning this unwavering assessment are a few convictions. First, we believe that there is a strong status quo bias in politics and governance, especially at the federal level. Big changes are hard to bring about. Apparently, this is why some have advocated never letting a crisis go to waste. There is also a natural, unceasing slide toward greater centralization of government authority (the exact opposite of the subsidiarity that we would recommend) and greater regulatory overbearance.

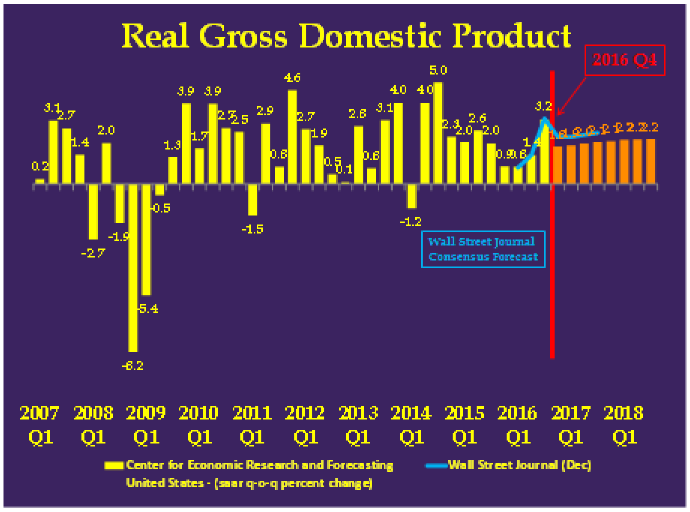
We don't believe that Trump's election has changed any of these underlying fundamentals. As it relates to policy, we believe Trump will not succeed in changing (and in many cases may not even attempt to change) many of the policies which are primary drivers of poor economic performance.

For one, there will be no significant change to monetary policy as long as Janet Yellen remains chair of the Fed. The Fed's era of unprecedented policy experimentation is likely to continue with ultra-low interest rates and interest paid on excess reserves. Even a full 100 basis point increase over each of the next two years would leave us below a normalized interest rate regime. And we don't expect increases anywhere near that size.

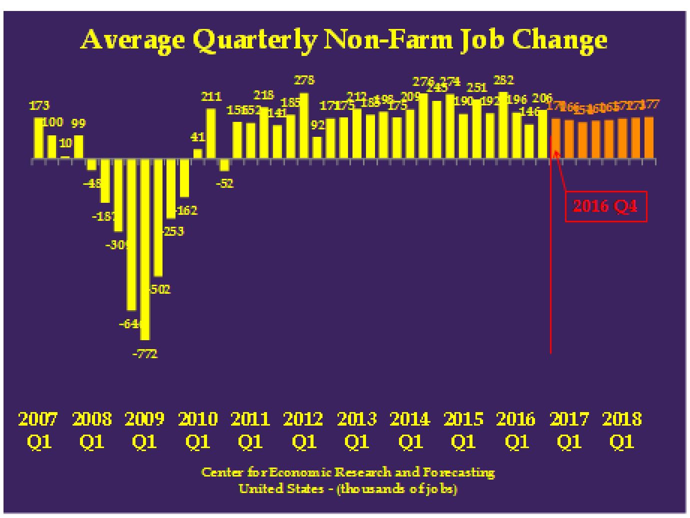
Additionally, we expect the era of ultra high federal budget deficits to continue. As a nation, we've gotten all too comfortable with half trillion dollar deficits, and under existing law, the CBO is forecasting half trillion dollar deficits in five of the next six years. Trump is unlikely to make a dent in these. His policies may even increase deficits.

Dramatic increases in the burden of regulation during the past eight years also explain some of the economy's underperformance. We would like to think that, with a business man and political outsider as president, economic policies are likely to tilt toward free markets, with a roll-back of regulation. Yet we are chastened by the two most recent midterm elections, which sent giant waves of new legislators to Washington, many of whom campaigned on the promise to roll back regulatory excess. They have little to show in terms of reform.

Therefore, our forecast is for continued slow growth with little change from the previous quarter's forecast. As has been the case for many years now, our forecast is under the consensus.



There are risks to our forecast. Our assumption that a Trump administration will achieve little in the way of significant policy changes could be wrong. Among the policies that Trump advocated during the campaign, a few could have a serious negative impact on the economy. Fortunately, these are among the policies that we see as *least* likely to be implemented. There are also policies, which Trump has advocated which could have a positive impact on the economy. We even assign moderate probability to a few of these being implemented. Unfortunately, the impact of these is likely to be muted by the other forces mentioned above.



To parse all of this out, we have identified the policy changes that Trump discussed during the campaign which we believe could impact the economy going forward. There are two policy categories, which we consider to be potential positives for the nation's economy: corporate tax reform and regulatory reform. There are three policy categories that we consider to be potential negatives: trade protectionism, immigration reform with mass deportation, and federal infrastructure spending. Our assumptions about each of these policy categories is summarized in the following table with elaboration in the following section.

	Impact on GDP	Impact on Deficit	Prob. of Implementation
Corporate Tax Reform	increase	decrease	moderate
Regulatory Reform	increase	decrease	moderate
Trade Protectionism	large decrease	increase	low
Deportations and Immigration Reform	decrease	increase	low
Infrastructure Spending	decrease	increase	high

Corporate Tax Reform

Lower corporate tax rates and the repatriation of foreign earnings are among the most promising policies that Trump advocated during the presidential campaign. High corporate tax rates accompanied by a myriad of deductions and exclusions create an inefficient system, which distorts the behavior of businesses. High rates not only reduce the return on investment and thus the aggregate level of investment, they place American companies at a disadvantage relative to their foreign counterparts. American businesses are penalized for bringing foreign earnings back to our shores. Lowering federal corporate tax rates and allowing the repatriation of foreign earnings would have a positive impact on GDP and would serve to reduce federal deficits. Unfortunately, these reforms are low-hanging fruit that has remained un-picked for decades. We would welcome large reforms in this area, but we'll be surprised to see anything more than modest changes. And the benefits of making US companies more competitive through changes to the tax code could be undone by protectionist policies or by continued bullying of individual companies, such as *Carrier*.

Regulatory Reform

Like corporate tax reform, unwinding the regulatory over-reaches of the past holds significant promise for the economy. A moratorium on new regulations would at least ensure that the economic impact of regulation can be no worse than it is now. A period of sustained de-regulation would increase GDP significantly and drive down deficits.

Repealing ObamaCare, by itself, would mean a big cut to government spending and an immediate reduction in effective marginal tax rates and the resulting disincentive to work.

Tax and regulatory reforms simply do not seem to be in the DNA of elected officials. Political inertia is overwhelming. However, the appointments of Tom Price as Health & Human Services Secretary, Andrew Puzder as Labor Secretary, and Scott Pruitt as EPA chief make us cautiously optimistic.

International Trade

A new era of protectionism is perhaps the single biggest threat that the Trump administration poses to the nation's economy. Tariffs would help a few individuals in select industries by raising prices for all consumers. Protectionism of this type would hurt the economy long term.

As revealed earlier, economists seldom agree on major issues, and even when they do, some can be counted on to do a complete about face when something like an electoral surprise (or a financial crisis) sets in. Yet, you will not find a topic in economics about which there is more unanimity or about which there has been steadier support than free international trade. In a survey of professional economists by the American Institute for Economic Research, 83 percent called to "remove remaining barriers to trade." No other single economic issue had as much support. Fortunately, we view protectionist trade policies as being unlikely in the new administration. If we are wrong on this assumption, we will be wrong on our forecast.

Immigration

Robust immigration has been part of the lifeblood of the Nation's economy since the beginning. The mass deportation of illegal immigrants as well as reductions to legal immigration would be a blow to the Nation's economy. Luckily, we view Trump's campaign promises in this area as the most unlikely promises to be implemented.

Federal Infrastructure Spending

Few issues have as much political appeal as infrastructure spending. Yet, as we learned during the Great Recession, there is no such thing as shovel-ready projects. Infrastructure spending didn't work then, and it wont help to boost economic activity now. Infrastructure spending by the Central Government is sure to decrease GDP by shifting resources away from private enterprise while also increasing federal budget deficits. We actually view implementation of this category of campaign promise as being fairly likely.

Forecast Charts