# US elections: what is the impact for the economy and the markets?

**Macro-economic analysis by Philippe Waechter**
Chief economist

Just a few days before the US elections, the economic context continues to look uncertain. Growth in the US has been weaker in 2016, while the world economic outlook is on a moderate slope. World trade is not progressing much and fails to act as a growth driver for the US. In other words, if the US economy wants to get back on the path to growth, it will have to rely on its domestic market, rather than external impetus.

In this respect, the two presidential candidates' programs offer very different, and often vastly diverging, solutions.

**In the Democrats' program, as embodied by Hillary Clinton**, the overall approach is based on the acknowledgment of the current long-term stagnation in economic growth i.e. a situation characterized by insufficient private demand to ensure robust growth, as well as by major revenue inequality. The solution put forward by Hillary Clinton is to implement an infrastructure investment program, which would be financed by more hefty income tax on the highest earners, thereby giving domestic activity a boost and hence reducing inequality in order to gradually eliminate the risk of long-term stagnation. The program's aim is to put growth back on an upswing by reallocating resources towards infrastructure investment, and this increased investment should in turn heavily encourage private investment. The program would be financed by higher taxes, so the impact on the public deficit would be limited and the public debt profile would only increase very slightly, and probably not be much different to what is currently projected by the US authorities.

**Donald Trump's program** takes a different take on the economy. It is based on two major principles: the first is to considerably cut back household and corporation tax in order to bolster domestic demand; the second is to give the United States back its power and independence of bygone days. This involves pulling out of trade commitments and treaties, and international political commitments, as well as the implementation of a more protectionist framework with a significant hike in customs duties, particularly with China. The overall aim is to drive the domestic market, while reinforcing the United States' independence from the rest of the world.

## Lasting consequences for the economy

The combination of these two major principles would have a number of somewhat contradictory effects that would affect all US citizens. The program to reinvigorate demand via tax cuts and infrastructure spending would lead to an increase in imports as Americans have been dependent on the rest of the world for manufactured goods for a long time, from Asia and especially from China. The external deficit would therefore increase. But at the same time, the aim of making the country more independent would lead to a negative shock on world trade with the risk of retaliatory measures from all countries hit by this new US policy. We can therefore expect pressure on customs duties and a contraction in world trade. All players in the US economy would be affected, not only companies that export but also companies that depend on exporters, and all Americans would be affected by retaliatory measures, so we cannot rule out a serious drop in activity. Slow or even negative growth and sharp tax cuts would combine to push up in the public deficit and lead to an unprecedented rise in public debt.

The choice of candidate will have lasting and very diverging consequences for the economy. For the rest of the world, the impact will also be very different depending on who wins. If the Democratic party wins, we know that Clinton is not opposed to free trade, although she is not a fervent supporter either (particularly the TTIP), so in other words she will not take protectionist measures but neither is she like to force greater trade agreements between countries or zones. From a political standpoint, the role the US plays in the worldwide equilibrium would continue.

**The end of the Fed’s independence?**

If the Republican candidate is wins, then the situation will look very different. The shock on world trade would affect all participants in the world economy, driving activity down. No-one will escape this negative shock, and in particular China. Canada and Mexico, which do considerable trade with the US, would also be penalized, and Europe would also be affected by this radical change. The other point to note is that the Republican candidate does not want to see the US guarantee world security, contrary to the situation we have witnessed since the Second World War, and this would cast doubt over NATO membership. There is a risk that this situation would create a context for mistrust and suspicion, which is never good news for growth.

Furthermore, as regards the overall impact of policies already implemented, Hillary Clinton is in favor of the agreement reached at the COP21 and wants to develop investment in alternative energy. Meanwhile, the Republican candidate has questioned this world climate agreement as he wants to go back on the limits that were established on $CO_2$ issues and monitoring.

The two candidates’ attitude on the Federal Reserve is also very different. We can expect few changes from Democrats: the candidate would guarantee the Fed’s independence and Janet Yellen could seamlessly continue to manage US monetary policy.

The Republican candidate’s approach is radically different. This can be seen in the vast number of criticisms of Janet Yellen’s strategy. The danger is that he could attempt to reduce the Fed’s independence, either heavy-handedly by changing the law, or by revisiting an objective from Republicans in Congress to cut back the central bank’s leeway, all with the aim of forcing the Fed to follow precise rules in its management of monetary policy. The Fed could still be independent in legal texts, but in practice it would not be.

On November 8, the Americans will make a decisive choice between two candidates’ programs that have very little in common. The choice will be either for continuity with a coherent framework, or the adventurous option that would be damaging for all concerned, including Americans.

## Asset allocation analysis by Nuno Teixeira

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US polls clearly point to a victory for Hillary Clinton, but should we take on a different slant for our portfolio ahead of this expected victory? Should we be relieved about the likely defeat for Donald Trump, whose more inflationary program would likely be a source of concern for the Fed and accentuate the increase in long-term rates, or conversely should we be worried about a candidate who is less pro-business than her challenger?

Whoever wins, we should remember that the implementation of the two candidates' policies will depend on compromises with Congress, due to the separation of powers. One of the decisive factors will be the majority in the House of Representatives, which looks set to remain Republican, but also the Senate, which is likely to move into Democrat hands. Even in an optimistic scenario for Hillary Clinton, she is unlikely to have the required majority in the Senate to be able to deal with Republican obstructions. The balance of power in the two chambers will automatically limit the reformist zeal of both candidates, who both suffer from low public opinion.

**More marked sector repercussions**

At this stage, apart from plans to reinvigorate infrastructure spending, neither of the two programs clearly weighs the scales in favor of Wall Street: Hillary Clinton would implement a slight increase in corporation and individual tax, while both candidates would increase the minimum wage. Furthermore, tax incentives to encourage companies with tax domiciliation abroad to move back to the US could push up the dollar, which would be bad news for US exporting companies. Donald Trump's program seems more positive for equities, with his proposal to cut back the maximum corporation tax rate from 35% to 15%, but his ultra-protectionist stance would dent companies with the most international exposure. As regards infrastructure, Hillary Clinton aims for $275bn in investment over five years, financed by tax hikes, while Donald Trump would go further, but would considerably worsen the budget deficit. In both cases, time to market would be long and the impact would be watered down with time.

However, sector repercussions will probably be greater: industrials, defense and oil would no doubt benefit from a Donald Trump victory, while Hillary Clinton, a fervent defender of the environment and clean energy, is planning a halt to subsidies on fossil fuels and is admired in Silicon Valley. The sector that most clearly reveals the differences between the candidates is healthcare: Donald Trump wants to call into question the universal healthcare program implemented by the 2010 Obamacare legislation, while Hillary Clinton wants to bolster the Medicare program for seniors. Her plans could dent the pharmaceuticals industry, assuming they manage to get through Congress.

**More favorable context for equity markets**

In our view, current momentum on the economic cycle and the maintenance of an accommodative monetary policy in the US seem to rule out the threat of a recession in 2017, although fresh infrastructure investment will probably have no direct impact next year and GDP growth is poised to stagnate around 1.5%. This is a decisive factor to promote gains, albeit modest ones, on the equity markets in the US but also worldwide.

The current context seems to provide a fairly reasonable window of opportunity for equities, as the short-term trend is relatively favorable in terms of macro-economic surprises: world consumer spending is consolidating, but investment is recovering slightly and world GDP growth seems to be recovering a little. In view of the potential leverage on corporate earnings of a short-term rise in nominal growth – partly driven by the rise in inflation – the relative stability of the dollar and of oil, we are fairly confident on the US equity markets (in particular tech stocks) and maintain a neutral position, despite their demanding valuation. We have a slightly positive slant on European equities and markets in the Pacific rim, excluding Japan.

From a tactical standpoint, we maintain a considerably more positive stance on equities than bonds, based on:

- projections for world growth that are still weak but downward risks are easing;
- extreme valuations on the bond market, even after the rise in rates seen since the start of September;
- the feeling that Eurozone investors should gradually factor in the upward inflationary trend out to mid-2017 and the likely announcement from the ECB in December of a less generous approach to its quantitative easing program during 2017, thereby promoting an upward normalization of long-term rates.

In view of the likely Hillary Clinton victory, we maintain a positive view on emerging markets, particularly on emerging debt, once the rise in short-term US bond rates and the dollar has been processed.

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