

A Trump presidency could bring a range of economic disasters

Written by Saul Eslake, Vice-Chancellor's Fellow, University of Tasmania

[Opinion polls](#) , [statistical prediction models](#) and [betting markets](#) are now all predicting a fairly comfortable victory for Hilary Clinton in the United States presidential election. However, they all said much the same about the prospect of British voters opting to remain in the European Union, before a majority of them actually voted to leave at the Brexit referendum in June.

In Brexit those wanting “change” felt much more strongly about it and were thus more inclined to vote, than those favouring the status quo. This might also be the case with Trump voters. So the possibility of a Trump victory can't be entirely dismissed – and the possible economic consequences of such an outcome are worth considering.

Precisely because a triumph for Trump has by now been so widely discounted – including by the financial markets – this outcome would prompt a much larger financial market reaction than a Clinton victory.

The unexpected outcome of the Brexit referendum saw the London share market fall by more than 5%, and the British pound by more than 8%, in the following 24 hours. And although the share market has since more than recouped its initial losses, the pound is now almost 18% below its pre-referendum level against the US dollar.

The financial market reaction to a Trump victory in the US presidential race is likely to be sharper. As the Reserve Bank of Australia governor Philip Lowe noted earlier this month, “the possible election of President Trump wouldn't be as benign an event”, as Brexit turned out to be. A [paper](#) published this week by Justin Wolfers and Eric Zitzewitz (of the University of Michigan and Dartmouth College, respectively) suggests that the US, UK and Asian share markets could fall by 10-15%, and that the Mexican peso would fall by 25%, in the event of a Trump victory.

From an historical perspective this is an extraordinary prospect, given that, as Wolfers and Zitzewitz note:

In almost every case back to 1880, equity markets have risen on the news that Republicans win

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elections and fall when Democrats win.

This is also because, at least superficially, Trump is proposing policies that are more likely to benefit rich households (who are more likely to own equities), while Clinton is explicitly advocating higher taxes on capital.

These findings are more understandable in the light of mainstream economists' assessments of the likely implications of the policy proposals put forward by the two main contenders. Out of 414 respondents to a [survey](#) conducted by the US National Association of Business Economists, 55% thought Hilary Clinton would "do the best job as president of managing the economy".

Only 14% thought that Donald Trump would (and that was 1 percentage point less than the proportion who nominated Libertarian Party candidate Gary Johnson). It's perhaps worth emphasising that this was a survey of *business*, not academic, economists.

This overwhelming view likely reflects three particularly important concerns to mainstream economists about the Republican presidential candidate's policies.

Differences in policies

Donald Trump's policies would significantly increase the US Budget deficit. The bipartisan Committee for a Responsible Federal Budget (CRFB) last month [estimated](#) that the combination of tax cuts and spending increases proposed by Donald Trump would add US\$5.3 trillion to US public debt over the next decade, lifting it from 77% to 105% of GDP.

By contrast, the spending and tax measures (cuts for some, increases for others) advocated by Hilary Clinton would boost public debt by US\$200 billion, to 86% of GDP, over the next decade. A [more recent analysis](#) of Donald Trump's tax proposals by the Urban Institute and Brookings Institution's Tax Policy Center suggests that they would increase US Federal debt by US\$7.2 trillion over a decade.

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While both candidates assert that their policy proposals would boost economic growth, which would in turn result in lower (rather than higher) budget deficits, the Committee for a Responsible Federal Budget (CRFB) [calculates](#) that economic growth would need to average 3.5% per annum over the next decade in order to stabilise the debt-to-GDP ratio without further tax increases. According to the CRFB, that would “likely require a level of productivity growth that has not been achieved in any decade in modern history”. Whereas the same objective would require economic growth averaging 2.7% per annum under Hillary Clinton’s proposals.

In addition to this, Donald Trump has consistently advocated a major upheaval in US trade policies, including the repudiation of the North America Free Trade Agreement (NAFTA) and the designation of China as a “currency manipulator”. This is something which under existing US trade laws would allow the imposition of tariffs of up to 45% on goods imported into the US from China.

The greatest adverse impact of such measures would be on low-income households in the US, as the result of having to pay much higher prices for goods that make up a large proportion of their spending. But there would also be an obvious negative impact on the Chinese economy – since China’s exports to the US account for 18% of its total exports, and just under 4% of China’s GDP.

It’s also hard to imagine that China wouldn’t seek to retaliate in some way against any such measures by a Trump Administration. In a [study](#) published by the Petersen Institute, Marcus Nolan, Sherman Robinson and Tyler Moran suggest that in such circumstances, the US economy would experience a recession in 2018 and 2019, with unemployment rising to 8.6%.

It’s hard to imagine how a trade war between the world’s two largest economies, Australia’s largest and third-largest trading partners, could have anything other than negative consequences for Australia.

Another concern for mainstream economists arising from Donald Trump’s economic agenda is his contempt for the independence of the US Federal Reserve. Trump’s suggestion that the Federal Reserve should have been more willing to raise US interest rates this year is not without some basis.

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But his [personal criticisms of Federal Reserve Chair Janet Yellen](#), combined with the fact that there are already two unfilled vacancies on the Fed's Board of Governors, suggests that the Fed could quickly become much more politicised in the event of a Trump victory. That would likely undermine confidence in US monetary policy, potentially leading in turn to a weaker US dollar and higher US bond yields.

Relationships between the US and other nations

Beyond these concerns to mainstream economists, the Republican candidate's attitude to longstanding US strategic alliances – with European countries, Japan and Korea – threatens to create much greater political uncertainty around the world. It may even prompt an “arms race” [entailing greater proliferation of nuclear weapons](#)

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Trump hasn't specifically listed Australia as [being among the US allies who](#) “aren't paying anywhere near what it costs to defend them”. It could be that Australia's status, as one of the few countries with which the US runs a trade surplus, puts us in a different category. Nonetheless, a deteriorating regional security environment could result in the Australian government concluding that it needs to spend more on defence.

It's important to note that not all of the foregoing concerns will be completely alleviated should, as seems more likely, Hillary Clinton become the 45th President of the United States. If that result were to be accompanied by a “clean sweep” of both the Senate and (less likely) the House of Representatives, left-wing Democrats such as Elizabeth Warren and Bernie Sanders will have a much larger influence on US economic policy.

The differences between Donald Trump and the left wing of the Democratic Party on trade policy, or on the independence of the Federal Reserve, are in reality quite small. So while a Clinton victory on 8th November is much the better outcome from an Australian perspective, it would not be in Australia's interests for her to win *too* well.

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