# Three calls for the US: We're in for some surprises

Could the economists have it completely wrong... and not for the first time? Donald Trump could turn out to be a boon for the US economy. But there are risks domestically and internationally

Our base case is that the 'Dealmaker in Chief' will water down his tariff threats to some extent

## 1 Call 1: Tariff bear trap

Despite decent economic growth and slower-than-expected progress on inflation, the cooling jobs market remains a key focus. The Federal Reserve retains an easing bias, and we look for it to cut rates by 25bp later this month before pausing in January. In general, we expect to see cuts of 25bp per quarter with a terminal rate of around 3.75%.

Tariffs are a big concern. A 60% tariff on Chinese products and 20% tariffs on everyone else would equate to a cost increase of $2,400 for every single American next year – based on zero substitution for American-made products and 100% pass-through to the US consumer. It could turn out to be even worse, with Donald Trump threatening 25% immediate tariffs on Mexico and Canada. Our base case is that the "Dealmaker in Chief" wins some concessions, and tariffs are watered down to some extent – he has lumped in immigration, drug trafficking, military spending, as well as 'free trade' to his demands.

Either way, this will still be very painful, but some factors will mitigate the impact. Some substitution for American-made products is possible, but the US manufacturing sector cannot meet all the demand at present. Fortunately, the stronger dollar means foreign manufacturers receive more of their local currency for each dollar of revenue, allowing them to be more flexible on pricing. The US-based importing company's profit margins could absorb some of the extra costs. Nonetheless, US consumers will feel a squeeze on living standards, and US exporters will be hurt by reprisals. As such, a higher inflation and slower growth environment looks probable.

## 2 Call 2: DOGE-Con?

The US government is running a fiscal deficit of 7% this year. Trump's Department of Government Efficiency (DOGE) has been tasked with saving trillions of dollars, but there is scepticism; even if every Federal government worker were to be fired, that would barely save $450bn per year.

Market fears regarding unsustainable government borrowing and inflation from tariffs could see investors demand a higher return for their risk, with US government borrowing costs surging higher. We forecast that the US 10Y yield breaks above 5% but could move even higher with mortgage rates and corporate borrowing costs hitting new cycle highs. At the same time, the dollar has already strengthened significantly but could go much further and break through parity against the euro thanks to a combination of positive interest rate differentials, geopolitical tensions and Trump's protectionist policies.

Additionally, if Trump follows through on his threat of an ultra-aggressive tariff regime, the world could descend into a long and immensely painful trade war. The implications for consumer spending power and inflation will be stark. Risk assets could come under severe pressure, and the chances of a recession would increase substantially.

## 3 Our bold call: To the moon!

It could, of course, be that economists have got it completely wrong (again!), and Trump truly is the economic messiah. Trump's tax cuts deliver meaningful growth and encourage businesses to resume hiring and investment. Meanwhile, immigration controls constrain labour supply, keeping wage growth robust, but AI is adopted widely and rapidly with huge productivity gains pushing the US economy into a new paradigm of full employment and little inflation.

Tariff threats succeed in opening up foreign markets to US companies while also leading to more announcements of foreign companies investing in US production facilities. Tariffs are quickly watered down and are much less of a threat to inflation and growth as the US transitions to become a manufacturing powerhouse.

Bond markets give Trump the benefit of the doubt and investors then start to buy into the productivity miracle and Treasury yields actually fall. This makes housing much more affordable, and with regulations slashed, we see new home construction surge. America has never had it so good!

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