US: Trump emboldened by strong mandate

Election clarity and a low tax, business friendly environment supports near-term growth, but higher long-term borrowing costs, trade tariff disruption and immigration constraints present headwinds for 2026 with inflation likely to remain more elevated than previously thought

View of the US Capitol, Washington DC

Clarity and low taxes boosts near term sentiment and spending

President-elect Donald Trump's decisive victory has already boosted risk sentiment as markets anticipate a lower tax, business friendly environment. The prospect of a smooth political transition to the new president also means that companies that delayed investment spending and hiring on election/regulatory uncertainty may now be prepared to start putting money to work. This improved clarity has led us to modestly revise higher our growth forecasts for the first half of 2025.

What happens thereafter will be determined more by what Trump delivers, and we suspect the scale of his victory will embolden him to push hard on his three main policies:

1. Extend and modify the Tax Cuts & Jobs Act which is currently scheduled to expire at the end of 2025, accompanied by lower corporate taxes and exempting tips from taxation.
2. Restrict immigration, particularly from the Southern Border, and,

3. Implement tariffs that he believes will raise revenue, promote re-shoring of production and boost economic growth and jobs.

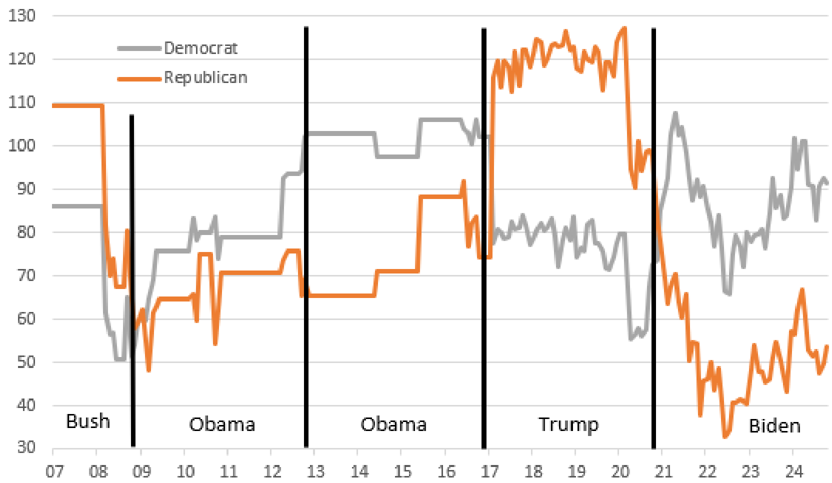
Tariffs are a clear threat to longer term growth

In terms of timing, he is likely to repeat his playbook of 2017 and focus on the domestic issues first. We strongly suspect the initial emphasis will be on immigration policy. He is also likely to set in motion his plans for reshaping government early on. He believes there is significant waste, abuse and fraud that needs to be tackled and he will be seeking to reduce regulation tied to energy and environmental policy.

The second phase will be on taxation, which should be the easiest to deliver on given Republican control of Congress. The third will most likely be trade tariffs, where he has proposed 60% tariffs on Chinese imports and 10-20% tariffs on products from elsewhere in the world.

We anticipate that the earliest time for tariffs to be implemented will be the third quarter of 2025, with a more likely time frame of the fourth quarter of 2025/first quarter of 2026. We also believe there will be a phased introduction given the potential for significant economic disruption. China would likely be impacted first, with a gradual series of tariffs introduced on different products from other countries coming in later.

Voter discontent lingers on long after an election: Conference Board consumer confidence by party affiliation



Source: Macrobond & ING

The Fed may cut more slowly and less aggressively than previously thought

In terms of the implications for Federal Reserve policy, the stronger near-term growth outlook and the prospect of tariffs and labour supply constraints pushing up prices over the medium to longer term may make the Federal Reserve more cautious on rate cuts than we previously anticipated. We still expect another cut in December, but it may be that after 100bp of cumulative easing, it chooses to pause in January and go more slowly – at, say, a 25bp per quarter pace and stopping earlier than we previously thought at 3.75%.

2026 risks skewed to downside on tariffs, immigration policy and higher long-term borrowing costs

Looking to 2026, while the income and corporation tax changes are a positive for economic growth, reduced immigration and forced repatriation could become a major constraint, particularly in industries such as agriculture. The number of American-born workers is already falling, and if the number of foreign-born workers slows sharply, this could act a brake on growth and pushes up labour costs. To counteract this, productivity would need to increase substantially.

Tariffs are another supply-side constraint on the economy. These are taxes that will be paid by US importers (typically wholesalers and retailers) when the products enter the US. They then decide whether to absorb the extra costs or pass them on either partially or in whole to the customer.

In an environment of sweeping tariffs it is difficult to immediately substitute foreign made for domestically-made products, due to capacity constraints. Consequently, the hit to retailers' profit margins and the erosion of household spending power from higher inflation could be significant in an economy where consumer spending accounts for 70% of all activity. Retaliation from foreign countries also has to be expected, which will create challenges for US exporters and manufacturers. If we see weaker global demand from escalating tit-for-tat trade tariffs, it could mean less investment and fewer jobs, not more as Trump expects.

The more significant headwind to growth could be come from higher US government borrowing costs. Fiscal sustainability concerns, where the US is already running a fiscal deficit of 7% of GDP, may lead to investors demanding a higher term premium for lending to the US government over the longer term. This could then be intensified by tariff induced inflation worries. 10Y Treasury yields have already risen from 3.6% to 4.5% and we are now forecasting the potential for 10Y US Treasury yields rising above 5%, which will push up borrowing costs broadly through the economy. The biggest impact would be felt around higher mortgage rates and corporate borrowing costs.

This is very much an early sense of the direction of travel; what Trump proposed during his election campaign and what he eventually delivers as president may be very different. Nonetheless, our view is that while the growth trajectory in the near term looks encouraging, the more aggressive he goes on trade and immigration policies the more challenges this may present for the US economy over time.

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