Economic Update

US 2016 Election Implications for NZ 10 November 2016

ASB

Trump in charge

- **Donald Trump wins the US Presidency and Republicans are set to retain control of both houses of Congress.**
- **Market's short-term risk-off reaction will in time shift to a focus on stimulatory economic policies.**
- **Longer-term impact on NZ a tug of war between US fiscal stimulus and any increased trade protectionism.**

President-Elect Donald J. Trump
Donald Trump has been elected the 45th President of the United States and Congress (House of Representatives and Senate) are set remain in Republican hands. Hillary Clinton has conceded the race to Trump. With the **Republicans in control of Congress, Trump will not face too many obstacles implementing his economic and foreign policy platforms**.

President-Elect Donald Trump's main economic policies

- Dramatically reduce income taxes
- Reduce business tax to 15%
- Boost infrastructure spending
- Targeted review of regulations that inhibit hiring
- Lift restrictions inhibiting energy investment
- Label China a currency manipulator
- Apply tariffs and duties to countries that cheat

The above is not a comprehensive list of Donald Trump's proposed economic policies. For more details, please visit his website https://www.donaldjtrump.com/positions/economic-vision

Trump's policies
At face value **Donald Trump's policies are inflationary** (see right for a brief summary). Lower taxes and higher government spending are stimulatory. Consequently, there is the prospect of **stronger US growth and an earlier lift in inflation pressures.** Furthermore, the proposed cut in the company tax rate would improve the after-tax return of equities, generating larger capital inflows into the US economy. US corporates would repatriate profits that are now subject to less tax into the US economy. **This mix of policies points to higher US interest rates, higher US equity prices and a stronger USD.**

Trump proposes to "label China as a currency manipulator", renegotiate NAFTA and "apply tariffs and duties to countries that cheat". If he imposed a **45% punitive tariff rate on all Chinese imports**, China's exports to the US could fall as much as 80%. Given 4.6% of China's GDP is exports to the US economy**,** we anticipate China's real **GDP growth will slow from 6.5% to 5.5%** as US tariffs imposed on China are offset by Chinese domestic stimulus measures. The slowing in China's economy would have some flow-on economic implications to the rest of Asia, including NZ and Australia. There would be the risk of China retaliating in some way, in turn hitting US growth. More broadly, there is **the risk of broader global protectionism and a shift in the geopolitical balance.** The world order risks having more friction if the US steps back from its engagement with its traditional allies and emboldens other global players.

Top 5 exports markets
Goods and Services, year ended June 2016

Rank	Country group	% of total
1	Australia	18
2	China	17
3	European Union	12
4	USA	12
5	Japan	5

Source: StatsNZ

The extent to which Trump is able to enact his policies depends on the **checks and balance from the 2 houses of Congress**. The Republicans still hold (narrower) majorities in both houses, which suggests Trump will have some freedom to enact policies. However, a **number of Republicans have an aversion to large government and to public debt**, which may mean restraint on fiscal policy changes. And **Donald Trump's aversion to free trade is not held by all Republicans**.

Short-term financial market implications
Much of the short-term implications are around global financial market volatility. Donald Trump does not get sworn in as President until January 20 (though may have plenty to say in the meantime).

The initial reaction was one of risk aversion, although that reaction was largely reversed during the European and US trading session immediately after the result.

In the short term, there is still some risk for the USD to edge lower mainly against EUR, JPY and CHF because of the uncertainty generated by the Republican trifecta (Presidency, House of Representatives and Senate) and the uncertainty of Trump's policies. Meanwhile, shaky financial market risk sentiment and the prospect for a more hostile approach to trade following Trump's victory, suggest commodity-sensitive currencies like NZD, AUD, and CAD are vulnerable to downside versus the USD.

Longer-term financial market implications
Once markets focus on the policy implications of Donald Trump's policies, the trend will distance itself from the knee-jerk risk aversion reaction. In fact, this shift could be starting already.

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Trump's economic policies are inflationary and will force the Fed to raise the Federal Funds rate at a faster pace than otherwise, and likely boost the issuance of US Treasury bonds. These shifts will push up US interest rates across the curve at a more rapid pace. **Here in NZ, the impact would be an earlier rise in term interest rates, as these rates are influenced by offshore equivalents.**

Over time the USD can make new cyclical highs against most major currencies. One driver will be the interest rate response to stronger inflation pressures. The other is any added capital inflows to the US through a lower company tax rate.

From a NZ context, there is potential for some added drag on the NZD to the extent that Chinese growth is impacted by US trade sanctions. **NZ's soft commodity export prices are sensitive to Chinese demand**, particularly for dairy products, though there is modest scope for stronger US commodity demand. But NZ's broader fundamentals are quite sound. Our current forecasts have the NZD/USD easing to 0.70 by mid-2017 (a 4% fall from this morning's level) before gradually climbing.

What does it mean for NZ growth over time?

First up, Donald Trump does not take office until January 20. It will be some time yet until his government legislates policy and for the subsequent effects to come through.

The implications of a Trump Presidency are mixed, and depend much on what policy shifts dominate NZ's export demand. The **US currently takes 12% of our exports** and is our 4th biggest export destination after Australia, China and the (current) EU bloc.

Income tax cuts (in particular) and stronger government spending would spur US economic growth – all other things equal. In isolation that implies **NZ would experience stronger export growth to the US**, including even faster growth in US tourist arrivals to NZ. And inbound migration from the US could be stronger at the margin, similar to the potential from the UK's Brexit vote.

But the **big uncertainty is to what extent any trade protectionism** undoes the impact of a US fiscal boost on NZ. Trump's proposal for punitive tariffs on China, and the likelihood of retaliation, would slow growth in the world's 2 largest economies. That in turn would flow through to broader global demand. **NZ has a large direct exposure to China**, and a large indirect one through Australia and broader Asia. China would also attempt to switch its exports to alternative markets, constraining global inflation.

But to provide some perspective, we anticipate the impact of punitive tariffs on China would knock its real growth rate down 1 percentage point to 5.5% - after accounting for Chinese stimulus measures. That isn't the end of the world, but it is hardly helpful. It will be important to keep tabs on the level of rhetoric Donald Trump has over China for clues as to how aggressive he is likely to be.

In our recent Quarterly Economic Forecasts we highlighted a **Donald Trump presidency as one risk to NZ's outlook**. Much of that risk comes from the trade aspect, yet developments on that front will be highly uncertain for some time. In the meantime, **NZ has a strong set of domestic fundamentals**, and our Quarterly growth outlook remains good enough at this point.

Long term, a shift to a greater degree of trade protectionism would be a slight negative for NZ. We depend heavily on exporting to pay for goods and services that our small scale means we are uncompetitive at producing ourselves. Trade enables us to turn grass into iPhones, but we can't do that transformation directly.

What does it mean for NZ monetary policy?

The immediate implications are not that apparent, and won't be for some time. Trump's policies might end up eventually creating more inflation pressure for NZ. But, ultimately, that influence boils down to how the outlook for NZ inflation gets altered by: 1) the overall change in our key trading partners' growth; 2) the overall impact on NZ monetary conditions.

The impact of the growth channel on inflation comes down to the balance of factors discussed in the section above – and it isn't clear yet.

The mix of NZ monetary conditions is likely to shift in favour of a weaker than otherwise NZD, counterbalanced by higher term interest rates via higher US interest rates. The NZD impact may overall win out, but at this stage the net effect does not look like it will be dramatic.

The **RBNZ has a lot of time up its sleeve** to assess the likely NZ impact of the Trump presidency. Even the next Monetary Policy Statement, on February 9, may be too soon to for the RBNZ to incorporate any economic changes given Donald Trump's inauguration is less than 3 weeks prior.

For the time being, we see the implications for NZ monetary policy as mixed. **We continue to expect the RBNZ to keep the OCR on hold at 1.75%. The risks are slightly skewed to the downside, with the incoming President Trump one further uncertainty to respond to.**

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