CURRENT ANALYSIS

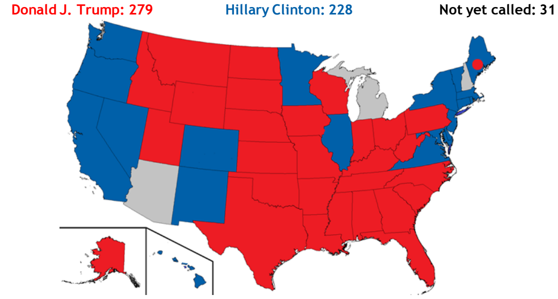
November 9, 2016

President-elect Trump

Looking at the impact on the Canadian and U.S. economies of the presidential election

Chart 1: 2016 U.S. Presidential Election Results

As of November 9, 2016.



Source: RBC Economics Research, New York Times

The United States elects Donald Trump President

Yesterday, November 8th 2016, U.S. voters elected Donald Trump president after a long and acrimonious presidential campaign. Results thus far show that Mr. Trump secured 48% of the popular vote and at least 279 electoral votes (exceeding the needed 270) (Chart 1). The Republican Party that Mr. Trump leads retained a narrow majority in the Senate and control of the House of Representatives leaving the Republican Party in control of both the executive and legislative branches of government for the first time since 2006. While a unified government will smooth the implementation of policy, it is unclear at this point whether the legislative agenda will be driven by the President or by Congress. Regardless, the election's outcome has important implications for the North American economy. As Mr. Trump and his team prepare for the transition into office on January 20th of next year, we assess some of the President-elect's stated policy positions for their likely impact on the economies of Canada and the United States if implemented.

The financial market reaction—will markets roll with a Trump win?

Financial markets will provide the first indication of the degree of concern about the policy outlook under a Trump administration with a negative reaction suggesting a deterioration in confidence and raising the prospect of knock-on effects weighing on consumer and business spending. While overnight movements were violent in futures markets, the early hours of the North American session have seen relatively muted reactions. The market response to announcements regarding Mrs. Clinton's emails in the closing days of the campaign — negative when the FBI revealed their investigation had been reopened and positive when the investigation did not lead to charges — signalled a clear market preference for Clinton. This a priori support for a Clinton victory reflected a positive view of the continuation of previous administration's policies and indicate markets held a dim view of a Trump presidency thanks to his stated proposals which endanger U.S. trade agreements and the independence of the Federal Reserve, and uncertainty over the implementation and form of his policy proposals. While turbulence in equity, currency and other markets may yet materialize, it is likely to prove short-lived given that details about the new government's policy priorities won't be known until after the January 20th inauguration. Near-term impacts on financial markets notwithstanding, markets continue to expect the Federal Reserve to move ahead with a rate hike in their December meeting as we go to publication.

A huge tax cut...

Central to Mr. Trump's economic plan is a tax cut estimated to cost over $4 trillion over 10 years and consisting primarily of cuts to businesses taxes and

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income taxes on the highest earners[1]. Specific tax measures for households include collapsing the number of tax brackets from seven to three, lowering the top marginal tax rate to 33% from 39.6%, creating deductions and credits for childcare, eliminating the alternative minimum tax, and capping itemized deductions. More far-reaching are Mr. Trump's proposed reforms to business taxes which include reducing the corporate tax rate from 35% to 15%, incentivizing profit repatriation, and creating or reworking a number of deductions. Mr. Trump's plan remains ambiguous on a number of points, including the treatment of 'pass-through' businesses, which could have substantial revenue impacts. Like the plan touted by Congressional Republicans, Mr. Trump's tax plan would likely strengthen economic growth if implemented thanks to lower tax rates on households and corporations. The plan, or one like it, is likely to be implemented given the alignment of Mr. Trump and Congressional Republicans on the issue. Lower U.S. corporate tax rates would put Canadian firms competing in the U.S. market at a disadvantage, but that may be offset by an attendant strengthening of U.S. growth.

… and a mixed bag on spending

In his platform, Mr. Trump offered a host of spending cuts to offset his tax plan. Specific policies include cuts to unauthorized appropriations and support for the 'Penny Plan' a proposed reduction of the caps on non-defense discretionary spending by 1% per year[2]. However, Mr. Trump has also outlined spending increases on defense, where he intends to repeal the defense sequester, and he intends to boost spending on infrastructure. The mix of spending cuts and increases laid out by Mr. Trump during the campaign is unlikely to offset the cost of his tax plan, leading to a significant increase in the deficit. Most analyses suggest that Mr. Trump's tax plan and spending initiatives would, when taken together, add substantially to the national debt over a 10-year horizon[3].

Growing protectionism in trade policy

Mr. Trump has signalled that his administration will be more protectionist than its predecessor as it harnesses public disapproval with trade agreements that emerged during this election campaign and have been echoed in other parts of the world. One casualty of protectionist sentiment may be the Trans-Pacific Partnership (TPP) which Mr. Trump has criticized and pledged to withdraw from[4]. This puts added pressure on the current administration which may bring the agreement to a vote during a 'lame-duck' session this year. More ominously for Canada, Mr. Trump has harshly criticized the North American Free Trade Agreement (NAFTA) throughout the campaign, warning that he intends to "immediately renegotiate the terms of that agreement to get a better deal for [American] workers"[5]. Unless Mexico and Canada agree to renegotiation, Mr. Trump has suggested that the U.S. would withdraw from the deal, with potentially negative consequences for the Canadian economy. Like Congressional Republicans, Mr. Trump favours the Keystone XL pipeline which may be approved by the incoming administration. If built, the pipeline has positive implications for the price Canadian oil fetches on world markets and for Canadian oil producers' export opportunities. It may also lessen the pressure on Canadian policy makers to approve alternative pipelines to improve Canadian oil's access to world markets. Given the importance of bilateral trade for both countries, any limitation on trade has negative implications for the Canadian and U.S. economies.

An about-face on climate change and the environment

Mr. Trump has called climate change a 'hoax' on a number of occasions and has pledged to undo many of the Obama administrations regulatory actions to address climate change[6]. Mr. Trump's specific policy proposals include encouraging fossil fuel development and scrapping 'overreaching' regulations. Mr. Trump indicated his intention to withdraw from the Paris Agreement which the United States ratified earlier this year. Given Mr. Trump's and Congressional Republican's hostility, further action on climate change is unlikely at the national level, which may introduce competitive disadvantages for Canadian firms, especially those in trade-exposed and emissions-intensive sectors, as Canada moves ahead with its national carbon pricing system.

Immigration and The Wall

Perhaps the starkest difference between Mr. Trump and Mrs. Clinton are their positions on immigration. While Mrs. Clinton promised comprehensive immigration reform during the election, Mr. Trump committed to stepping up efforts against undocumented immigrants[7]. Mr. Trump's plan includes ending so-called sanctuary cities, increasing deportations, and strengthening border security in the form of more enforcement agents and a wall on the Mexican border. The plan would continue to lock millions of people out of the formal economy with potentially negative implications for the labour force. To the extent that a Trump administration is less open to immigration and is able to implement its policy agenda, U.S. population and labour force growth may slow with negative implications for long-run economic growth. A less welcoming United States may also lessen the competition for immigrants faced by Canada as it aims to boost its immigrant intake to offset the effects of an ageing workforce.

The Bottom Line: the gap between 'say' and 'do'

While the policy proposals of the President-elect have large potential ramifications for the U.S. and Canadian economy, they remain *potential* changes for now and this will keep uncertainty elevated in the run up to the inauguration in January. As it stands, we are inclined to leave our forecasts for both the Canadian and U.S. economies unchanged in the wake of the election until details emerge as to what will be implemented and when. However, it should be noted that in our view key risks to our forecast include Mr. Trump's tax cut, which if passed would add to U.S. growth even as it worsens the fiscal balance, and potential changes to trade policy, which may have negative impacts on the North American economy to the extent that they disrupt cross border trade flows or introduce uncertainty in firms' decision making. Moving forward we will closely monitor the new government's announcements and policy priorities for their impact on the rate and composition of economic growth in both countries.

References

1. Based on estimates from the Tax Policy Centre, Tax Foundation and the Committee for a Responsible Federal Budget. Estimates considered were made on a static basis.
2. Donald J. Trump for President (2016). "Economy" Policy factsheet.
3. Based on estimates from the Tax Foundation and the Committee for a Responsible Federal Budget.
4. Donald J. Trump for President (2016). "Trade" Policy factsheet.
5. Ibid.
6. Donald J. Trump for President (2016). "Regulations" Policy factsheet.
7. Donald J. Trump for President (2016). "Immigration" Policy factsheet.