Research US

Trump's budget seems dead on arrival in Congress – do not expect too much of Trumponomics

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Conclusion: do not expect too much of Trumponomics

- Yesterday, the Trump administration released the long-awaited budget for the fiscal year 2018 and the administration's priorities for the next 10 years. The Trump administration expects to eliminate the government deficit by 2027 due to a combination of higher GDP growth (3% per year) and large welfare spending cuts.

- We think it is unlikely the supply-side effects from Trump's economic policy (deregulation, tax reform, infrastructure investments) will increase GDP growth to 3% even if fully implemented.

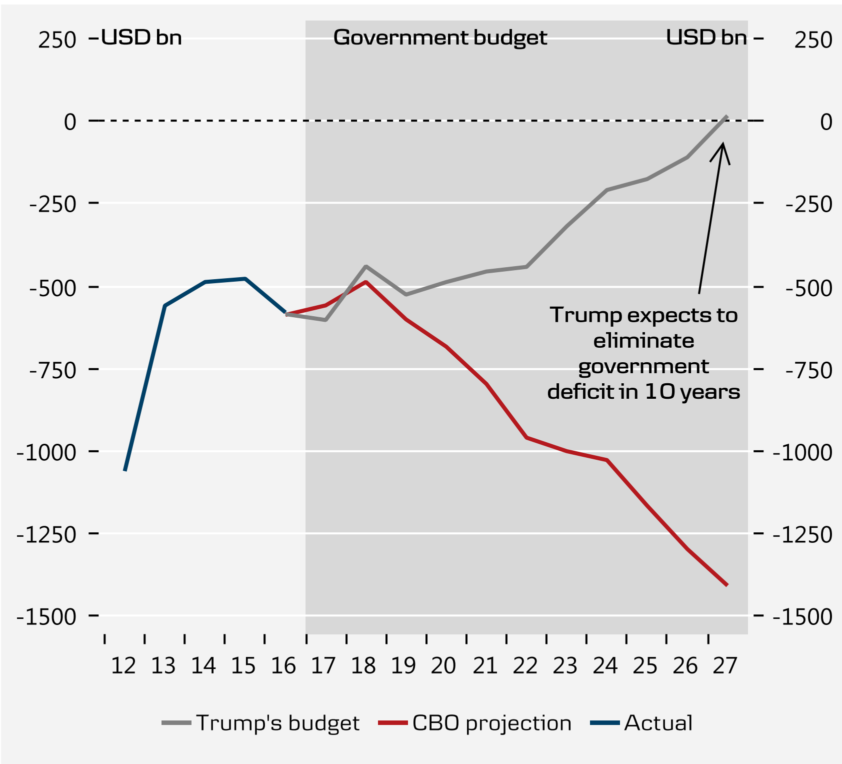
- The budget reflects the Trump administration's expectation of full implementation of its policy proposals, which we think is unlikely given the disagreement within the Republican Party. Although all Republicans share the same goal to cut and simplify taxes, they disagree on the financing. While moderate Republicans do not want to make big cuts in other parts of the budget, fiscal hawks do not want to increase the government budget deficit/debt to finance this. Thus, we may see a repetition of the Republicans' difficulties to change Obamacare.

- We do not expect the US Congress to pass a new budget before the fiscal year starts on 1 October, hence Congress likely needs to pass a short-term funding bill to keep the US government running. This also means there is a risk of a government shutdown by 1 October – also note that the US Treasury exhausts its extraordinary measures during the autumn and Congress has still not found a solution to the debt limit issue.

- We maintain our long-held view that Trumponomics will come later and be smaller than pledged. We do not expect a deal on tax reform before end of the year, at the earliest.

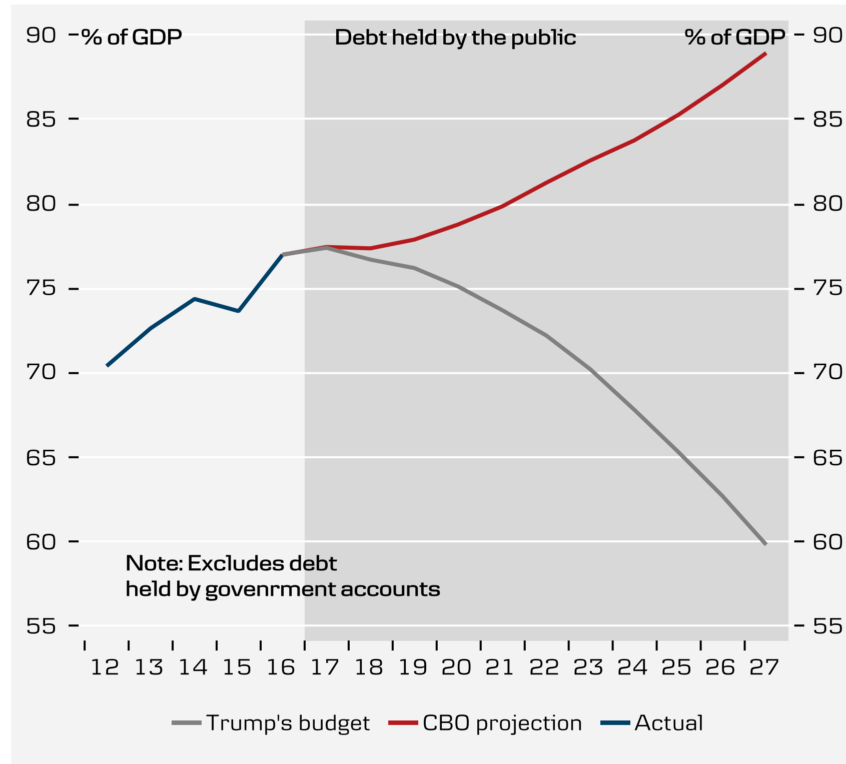
Trump's budget very ambitious with respect to public finances

Trump expects to eliminate deficit in 10 years



Source: CBO, Trump's budget

Debt held by public to fall to 60% in 10 years



Source: BEA, BLS

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Trump proposes major welfare spending cuts (especially after his term)

Proposals in the 2018 budget, USD bn (Deficit increases (+) or decreases (-))	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	Accumulated
Major initiatives	**4**	**10**	**-32**	**-67**	**-122**	**-185**	**-228**	**-276**	**-369**	**-458**	**-1,723**
Repeal and replace Obamacare	25	30	-5	-30	-35	-40	-40	-50	-50	-55	-250
Support private/public infrastructure investment	5	25	40	50	40	20	10	5	5	-	200
Reform financial regulation	-	-2	-3	-3	-4	-4	-4	-4	-4	-5	-35
Establish a paid parental leave program	1	1	2	2	2	2	2	2	2	2	19
Reform Medicaid and the Children's Health Insurance Program (CHIP)	-2	-3	-10	-20	-40	-60	-80	-105	-130	-165	-616
Reform the welfare system	-9	-16	-23	-25	-30	-33	-33	-34	-35	-34	-272
Reform Federal student loans	-4	-7	-11	-13	-15	-17	-18	-19	-19	-20	-143
Reduce improper payments	-	-1	-2	-3	-5	-5	-10	-21	-38	-58	-142
Reform disability programs	-1	-1	-2	-2	-3	-5	-8	-12	-17	-22	-72
Reform retirement benefits for Federal employees	-4	-1	-3	-4	-6	-7	-8	-9	-10	-11	-63
Others	-7	-15	-15	-19	-26	-36	-39	-29	-73	-90	-349
Reprioritise discretionary spending	**25**	**-13**	**-63**	**-113**	**-152**	**-185**	**-214**	**-243**	**-271**	**-299**	**-1,528**
Debt service and indirect interest effects	**-**	**-**	**-1**	**-5**	**-12**	**-24**	**-38**	**-55**	**-76**	**-101**	**-311**
Effect of economic feedback	**-2**	**-24**	**-63**	**-102**	**-153**	**-213**	**-267**	**-333**	**-408**	**-496**	**-2,062**
Total deficit reduction	**27**	**-27**	**-159**	**-287**	**-439**	**-607**	**-747**	**-907**	**-1,124**	**-1,354**	**-5,625**

Source: Trump's budget

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Not very specific on neither tax reform nor infrastructure

- Unfortunately, the Trump administration is still not very concrete about tax reforms in the budget proposal, just repeating the tax reform principles published previously.

- It also makes it more difficult to judge/analyse the budget, as many important variables are missing.

- In terms of infrastructure, Trump wants to spend USD200bn over the next 10 years, the rest of the funding of USD1,000bn must come from private funds. The budget says that *'simply providing more Federal funding for infrastructure is not the solution. Rather, we will work to fix underlying incentives, procedures, and policies to spur better, and more efficient, infrastructure decisions and outcomes, across a range of sectors, including surface transportation, airports, waterways, ports, drinking and waste water, broadband and key Federal facilities'.*

Budget assumes GDP growth of 3% due to supply-side effects

- The Trump administration expects real GDP growth to increase to 3% in the long term due to positive supply-side effects stemming from
  - Tax reform
  - Infrastructure investments
  - Deregulation
- The administration argues it should boost productivity growth.
- **However, the government does not outline the analyses behind the assumptions.**
- 3% is also much higher than the average since the financial crisis (2.1%) and CBO's latest projection (1.9%).
- Committee for a Responsible Federal Budget finds that even if labour force, capital and productivity growth rates match 1990s levels, US GDP can grow 2.9% at most, see analysis here.

Real GDP growth of 3% seems unrealistic

Source: Trump's budget, CBO

Trump's budget unlikely to pass Congress in its current form

- Although all Republicans share the same goal to cut and simplify taxes, they disagree on the financing. While moderate Republicans do not want to make big cuts in other parts of the budget, fiscal hawks do not want to increase the government budget deficit/debt to finance this. Thus, we may see a repetition of the Republicans' difficulties to change Obamacare.

- For the same reasons, it is not a big surprise that some Republicans have already rejected Trump's budget and the budget seems dead on arrival in Congress (see Bloomberg). That said, the President's budget proposal is always just a starting point, as it is only Congress that can grant funding.

- **We maintain our long-held view that Trumponomics will come later and be smaller than pledged. We do not expect a deal on tax reform before the end of the year, at the earliest.**

- This also seems in line with recent comments from House Speaker Paul Ryan and Treasury Secretary Mnuchin. Mnuchin said today that he hopes to get the tax reforms done 'this year', previously he aimed at before Congress's August recess (see CNBC).

US budget process – President's job to issue budget proposal but only Congress can actually grant funding

Trump needs Congressional support to implement economic policies

February to May (normally October to January)
The President, in cooperation with the Office of Management and Budget (OMB), prepares a budget proposal

May (normally February)
The President submits a budget request to Congress.

It is the starting point for the annual budget process, but it is not legally binding.

In 1-2 months (normally March)
The Congressional Budget Office (CBO) publishes an analysis of the President's proposal

Negotiations set to start soon but unlikely to be concluded before start of fiscal year 2018 on 1 October
Based on the President's proposal and the CBO analysis, the House and Senate submit their own budget resolutions (sets overall spending limits for federal agencies but does not decide funding for specific programs)

A compromise – called 'Conference Report' – is then passed in both chambers.

New fiscal year begins 1 Oct
If the President has not signed a conference report before 1 October when the new fiscal year begins, Congress will have to pass a short-term funding bill to keep government running. In other words, we may face a government shutdown by 1 October.

Trump's budget is for the fiscal year 2018 (1 Oct 2017 – 30 Sep 2018)

Source: Wikipedia

Very packed calendar makes it more difficult for the Republicans

Subject		May-17	Jun-17	Jul-17	Aug-17	Sep-17	Oct-17	Nov-17	Dec-17	Jan-18	...	Nov-18	Nov-20
Trade	Trade deficit review (90 days)												
	Trade deals review (180 days)												
	US-China 100-days plan for trade talks												
	FX manipulation report						Mid-Oct						
Foreign policy		Trump meets with EU's Tusk & Juncker 25 May, attends G7 meeting (26-28 May)		Possible Trump-Putin meeting									
Economic policy	Tax reform	Full budget released 23 May				Negotiations on tax reform (deal unlikely until late 2017)							
	Infrastructure					End-2017 at the earliest, likely postponed until next year							
	Debt limit					Extraordinary measures exhausted in autumn							
	Fiscal year					Fiscal year 2018 starts 1 Oct (risk of government shutdown)							
Fed		Nominate three new Fed governors					Fed Chair Nomination			Yellen's term expires on 31 Jan			
Health care		Bill has passed the House - the Senate is now rewriting its own bill											
Elections & recess					Congress's August recess							Midterm elections	Presidential election

Risk of government shutdown on 1 October

Congress unlikely to pass a new full budget before the fiscal year starts on 1 October

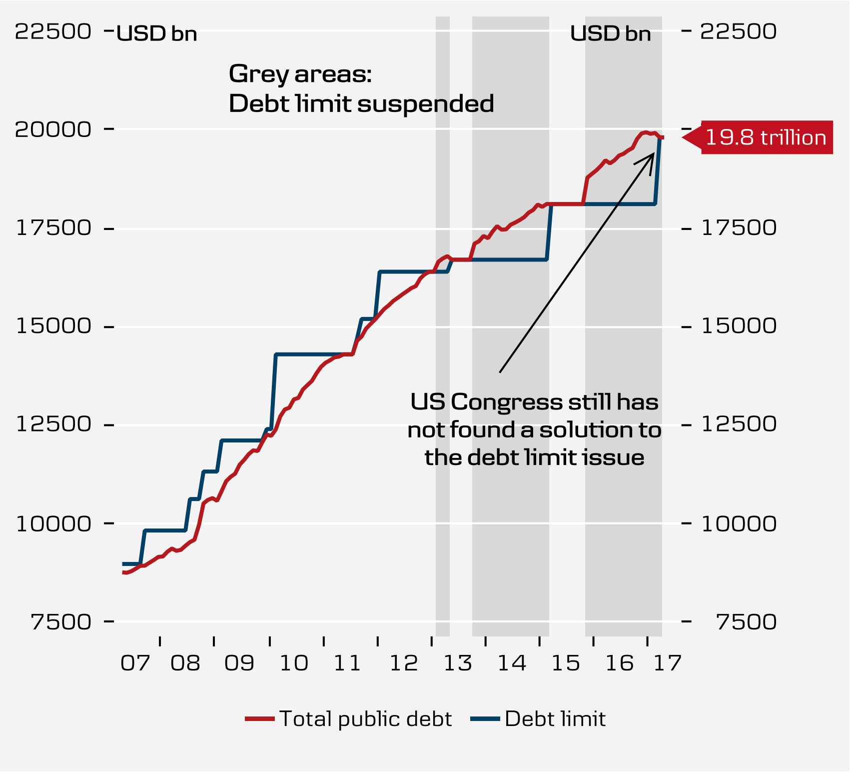
- We do not expect the US Congress to pass a new budget before the fiscal year starts on 1 October, hence Congress likely needs to pass a short-term funding bill to keep the US government running.

- This means there is a risk of government shutdown by 1 October.

- Also note that the US Treasury exhausts its extraordinary measures during the autumn but Congress has still not found a solution to the debt limit issue.

- Although we expect Congress to find a solution eventually, as no one has an interest in the US defaulting on its obligations, it may become a market theme at some point.

Still not solution to debt limit issue



Source: US Treasury

Difficult for Trump to get his economic plan through Congress – high risk of disappointment

Treasury Secretary Mnuchin hopes to get tax reform done 'this year' (previously he said before August recess)

Trumponomics in a very optimistic scenario

	IDEA	Comprehensive and permanent economic plan? Smaller and more temporary economic plan?
Q4 17	DECISION	Takes time for the politicians to pass the necessary legislation – Trump probably needs to make compromises with Republican members of Congress (Obamacare is a proxy)
Q1 18	IMPLEMENTATION	Takes time to implement the policy (projects may not be 'shovel-ready' so projects have to be defined and designed first)
Q2 18	GROWTH IMPACT	Infrastructure: Longer policy lag but bigger growth impact Tax cuts: Smaller policy lag but smaller growth impact

H2 18 Biggest growth impact in second half of 2018

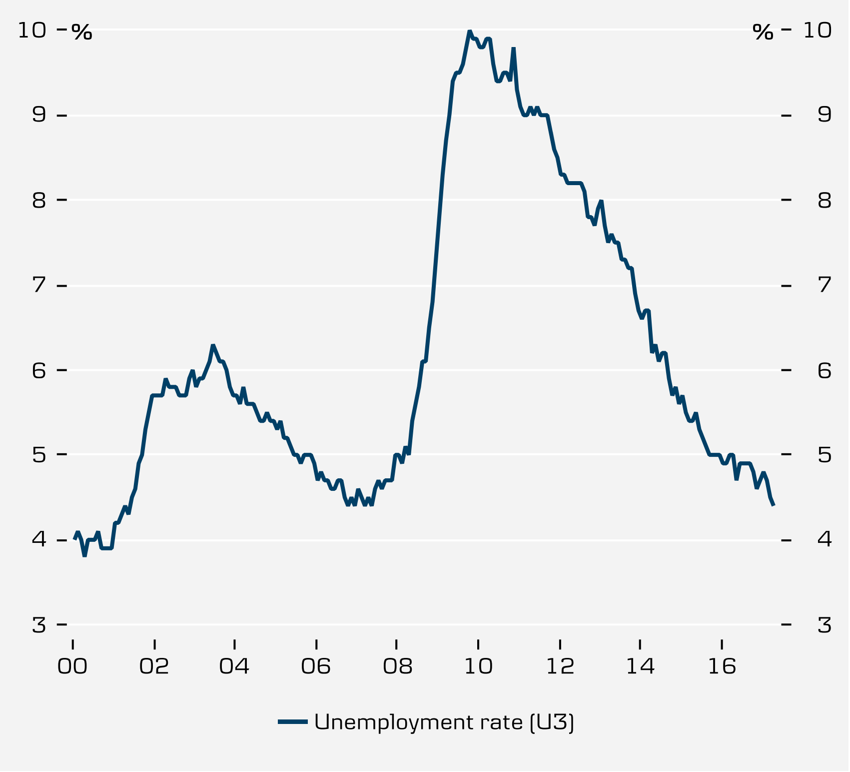
Source: Danske Bank Markets

Fed has said it wants to offset more expansionary fiscal policy

Fed thinks output gap is almost closed

- Although Trump's budget projects government primary deficit to decline over the next 10 years, it likely will if fully implemented given the very optimistic assumptions behind the calculations.
- However, even if fiscal policy becomes more expansionary, we do not think GDP growth will increase in coming years, even taken the fiscal lag into account.
- Fed has said several time that it wants to fully offset more expansionary fiscal policy by raising rates more than currently indicated (three hikes a year according to the latest projections from March).
- Fed argues that it is the wrong time to boost fiscal policy, as the output gap is already almost closed to begin with and the Fed fears overheating of the economy.
- That said, the Fed welcomes reforms that can boost productivity growth and hence long-term growth.

Unemployment more or less back to normal



Source: BLS

However, note that Trump may appoint as many as five new Fed governors over the coming year

Fed Chair Yellen

Term expires: Feb 18 (as chair),
Jan 24 (as Governor)
Dovish, appointed by Obama

Vice Chair Fischer

Term expires: Jun 18 (as vice chair),
Jan 20 (as Governor)
Neutral, appointed by Obama

Powell

Term expires: Jan 28 (as Governor)
Neutral, appointed by Obama

Brainard

Term expires: Jan 26 (as Governor)
Dovish, appointed by Obama

Three vacant seats

? ? ?

Trump still needs to nominate three new Fed governors

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Less pressure on Trump as Republicans have accepted the investigation into Russian interference/ties

- Overall, it has been some very chaotic weeks for President Trump with lots of poor cases, including the firing of FBI Director Comey and the story that Trump had asked Comey to end the FBI's investigation into ties between former White House national security adviser Michael Flynn and Russia (which is illegal).

- Now former FBI Director Robert Mueller is appointed as a special counsel to oversee the investigation into Russian interference in the 2016 election and possible collusion with his campaign.

- Trump has tweeted that *"This is the single greatest witch hunt of a politician in American history!"* continuing his lash out on mainstream media/politicians.

- We do not expect Trump to be impeached on this. Firstly, the investigation is likely to take several years. Secondly, it is a difficult process to impeach (let alone convict) the President (only two Presidents have been impeached, Nixon resigned before) – see also next slide.

- Wikipedia: *"To bring articles of impeachment against a president requires a majority vote in the House of Representatives. When the case is tried by the Senate, a vote of at least 2/3 of those present is required to convict and remove the president from office"*

- The Republicans' accept of the investigation into Russian interference/ties means that they can now move on with its legislative agenda. That said, as we have stressed several times, we expect Trumponomics will come later and be smaller than previously pledged. We already have a very packed calendar (see next slide).

Impeachment of the US President – a difficult process

HOUSE

House Judiciary Committee decides whether or not to proceed with impeachment

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The Judiciary Committee will send a resolution composed of one or more “Article of Impeachment” to the full House stating that impeachment is warranted and why

↓

The full House will debate and vote on each Article of impeachment

↓

Should any one of the Article of Impeachment be approved by a simple majority vote, the President will be “impeached” (remain in office pending the outcome of the Senate impeachment trial”

↓

SENATE

The Senate formulates rules and procedures for holding a trial

↓

The trial will be held with the President represented by his lawyers. A select group of House members serves as “prosecutors”. All 100 Senators are acting as the jury

↓

The Senate votes on a verdict. A 2/3 supermajority vote of the Senate will result in a conviction

↓

The Senate will vote to remove the President from office.

↓

The Senate may also vote (by a simple majority) to prohibit the President from holding any public office in the future

Source: www.thoughtco.com

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