WEEKLY ECONOMIC COMMENTARY

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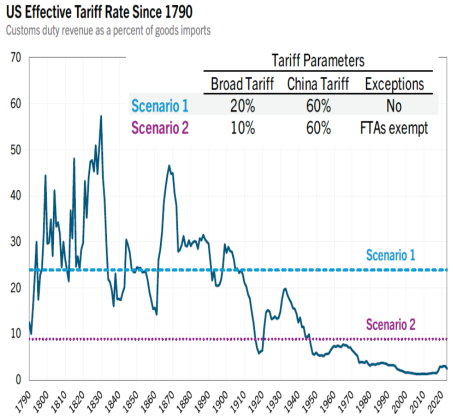
In sport, play is limited by time or innings. Lineups are set, rules are fixed and boundaries are defined. Winners are determined objectively.

Commerce and politics operate differently. Players come and go, the rules are changeable and the clock never stops. It is much harder to identify victors in these arenas.

The lineup in Washington will be changing next year. Other players around the globe will be challenged to adapt their tactics to the new roster, and the new rules they will try to enforce. Following is a look at how selected countries and regions may fare under a second Trump administration.

Europe

The European continent is extremely vulnerable to Trump's agenda, owing to close commercial and national security linkages with the United States. The most immediate economic worry will be tariffs, as the incoming president seeks to close the €155 billion trade deficit with the eurozone; he has threatened a blanket 10% to 20% levy on all imports. Germany, Italy and Ireland are among the most vulnerable due to their high export volumes to America. Germany's struggling auto sector will be top of the list.



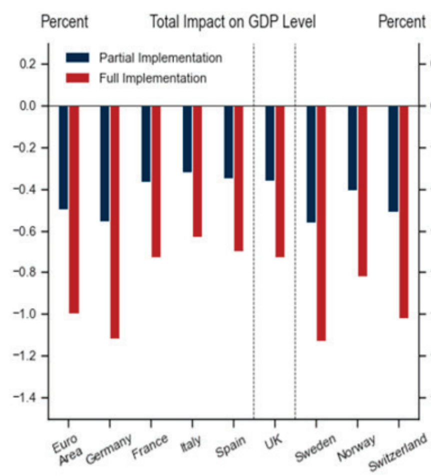
Sources: BEA, Yale University Budget Lab, Bloomberg

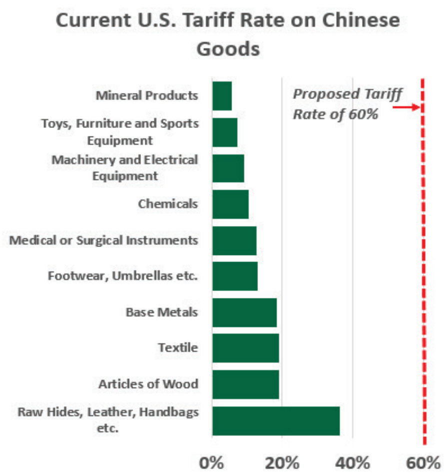
The implications for the U.K. economy will also be significant. America is Britain's most important bilateral trade, security and defense partner. Industries like pharmaceuticals, medical goods, automotive and liquor would be particularly exposed to new U.S tariffs.

Trump's trade agenda, if implemented to the fullest, will likely deliver a hit of anywhere between 0.6% to 1.1% to real gross domestic product (GDP) across the European continent, according to Goldman Sachs.

The trade deficit is not the only elephant in the room. European nations will come under increased pressure to decouple from China. The incoming president could impose counter-measures against European digital services taxes and states that have implemented the Organization for Economic Co-operation and Development's global minimum tax, as it is seen to disadvantage American corporations.

The President-elect also wants all the European states to meet the defense spending targets required of North Atlantic Treaty Organization (NATO), threatening withdrawal of U.S troops and weapons. Out of the 32 NATO allies, seven European states are unlikely to meet the 2% of GDP spending target in 2024, including Italy and Spain.





Sources: GS, Morgan Stanley

Asia Pacific

U.S.-China decoupling is going to accelerate under Trump 2.0.

China is bracing for an unstable and unpredictable path ahead, at a time when its economy is struggling to return to pre-pandemic levels of growth. During Trump's first term in office, goods from China faced tariffs of as much as 25%. Proposed tariffs as high as 60% on Chinese imports, along with more technology controls, would decimate Chinese trade with the U.S.

Escalating trade disputes will significantly hurt corporate confidence and capital expenditures. Seven years of trade tensions have allowed mainland businesses to diversify, and America has also reduced its dependence on Chinese products. However, shrinking external and weak domestic demand will further exacerbate deflationary pressures.

The looming trade war could set in motion the steady decline of China's decades-old manufacturing and export growth model. Global supply chains will come under scrutiny as the Trump administration will also likely target Chinese goods being rerouted to the United States through other markets.

Beijing could retaliate by targeting U.S. farm products, blacklisting American corporations and restricting access to essential materials like rare earth metals. However, in order to offset tariff costs, Chinese policymakers will have to weaken the renminbi, increase export tax rebates and implement more stimulus. An unprecedented scale of currency depreciation will be required to mitigate the higher levies. According to Morgan Stanley, factoring in tariffs already in place since 2018, the renminbi would need to fall by 50% against the dollar to keep U.S. import prices stable.

The Australian economy will not be immune from repercussions from the U.S. election, as it shares close commercial ties with both China and the United States. About 97% of Australian imports into the U.S. are currently tariff-free, thanks to a free trade deal signed in 2004. Beyond the shock of potential new tariffs, Australia could be collateral damage of a renewed U.S.-China trade war. Weaker demand for Chinese goods would diminish demand for Australian input commodities like iron ore. If all of Trump's policies are implemented, Australia's economic growth would be between 0.8% and 1.5% lower than it would otherwise have been, according to an analysis by KPMG.

North America

Few nations are as closely tied with the U.S. as Canada and Mexico, with supply chains deeply integrated and continental trade flows exceeding a trillion dollars annually. Trump's promise of universal 10% tariffs raises worries across this network.

USMCA could go back to the drawing board in 2026.

Canada exports 75% of its goods to the U.S., with energy, autos and other heavy manufacturing industries among the top export products. These industries rely on its southern neighbor for raw inputs and as a market for finished products. Any retaliatory tariffs from Canada are only going to compound the pain of these businesses, in the form of higher input costs. Increased American oil production and weaker demand from China would weigh on the Canadian energy industry.

The Trump administration could spell even bigger trouble for Mexico, not only because of the large trade surplus it runs with the U.S. The President-elect has warned to implement "whatever tariffs are required — 100%, 200%, 1,000%" to prevent imports of Chinese cars via Mexico and a blanket 25% tariff on all Mexican goods due to the flow of migrants through the country.

His administration is also likely to insist on modifications to the United States-Mexico-Canada Agreement, the deal he inked during his first term, when it comes up for review in 2026.

As much as the President-elect would like to believe that the U.S. will emerge a winner from trade disputes, past trade conflicts have not worked to any nation's benefit. Losing the least may have to count as a win.

Irreconcilable

As more election results were confirmed this week, the red sweep took shape. The Republican party will control the presidency and both chambers of Congress, and the Trump agenda will face few obstacles. But on fiscal matters, Trump did not exactly receive a blank check.

The rules of the Senate allow a dissenting member to halt debate on a vote through a filibuster. Once a dramatic act of holding control of the floor through a never-ending speech, the measure has devolved to a simple procedural objection. A cloture vote can end the filibuster, if a supermajority of 60 of the 100 senators agree. Republicans hold 53 seats, and their Democratic opposition is unlikely to offer much in the way of compromise.

Used excessively, the filibuster could grind the Senate to a halt. As such, the rules of the chamber have been amended to allow necessary votes to proceed. Simple majorities are sufficient to confirm federal judges and executive branch appointees. 51 senators can also pass fiscal measures through reconciliation, which comes with a host of limitations.

Senate procedures limit reconciliation measures to one annual budget bill per fiscal year. Any parameters must pertain to government revenue or expenditure. Recognizing the potential for this measure to lead to unchecked spending, the late fiscal conservative Senator Robert Byrd memorialized the Byrd Rule, requiring reconciliation measures to be deficit-neutral after ten years.

The Tax Cuts and Jobs Act (TCJA) of 2017 was passed through reconciliation. The fiscal balance requirement is the reason the bulk of it will expire after 2025, setting up today's debate about its extension. While the Democratic platform favored extending most of the personal income tax provisions of the TCJA, they also proposed offsets through tax increases that Republicans will not support. Republicans will go it alone through the reconciliation process.

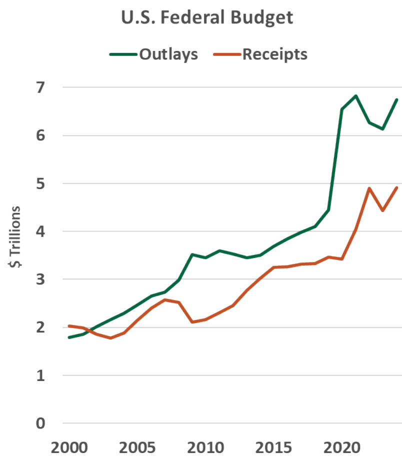
The Republican House majority is still being tallied, but will be thin. The TCJA passed in a different environment of a sluggish economy and lower levels of debt. Amid soaring deficits and inflationary risks, Republicans' appetites for further cuts may be much smaller this time around.

Fiscal constraints may impede the electoral mandate.

Fiscal Conditions At Trump Term Outsets

	2017	2024*
Deficit (% of GDP)	-$665 bn (3.4%)	-$1.83 tn (6.2%)
Debt (% of GDP)	$20.5 tn (102%)	$36.0 tn (121%)
Debt Service (% of tax revenue)	$262.5 bn (7.2%)	$881.6 bn (16.7%)
Republican House margin	+47	+4

** Fiscal years; House seat margin not final, based on vote totals as of November 14.*



Sources: Office of Management and Budget, U.S. Treasury, Bureau of Economic Analysis, Haver Analytics

The reconciliation process has been pushed to its limits to allow past presidents' priorities to pass. The next Trump administration may try to justify border security and tariffs as fiscal measures that will lead to budgetary savings. But as the costs of these measures rise, they will cut into the fiscal headroom to keep taxes low.

An originalist may note that the Constitution does not contain words like reconciliation, cloture, Byrd or deficit. Congress has placed these rules upon itself, and they could be amended or rescinded. However, veteran politicians understand that power is cyclical, and every party will have its turn in the minority. Safeguards repealed today may be sorely missed in the future.

More likely, Republicans will find a way forward with a reconciliation bill next year that extends most of the Tax Cuts and Jobs Act and adds a few Trump priorities. Tax hikes are a dead letter, but proposed tax cuts may also be a bridge too far. The tax code is positioned to carry on for another decade, again bounded by reconciliation. We'll be braced for another tax debate in the mid-2030s.

Against The Wind

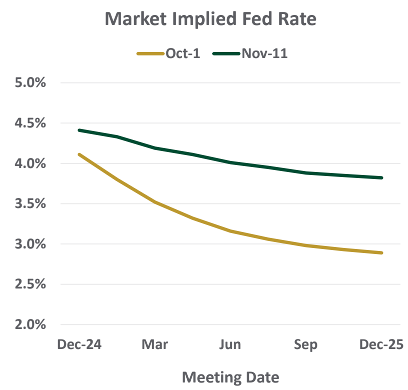
Lost in the excitement of election week was a meeting of the Federal Reserve. At its conclusion, interest rates were lowered by another quarter-point. But where they are heading from here is a matter of increasing uncertainty.

Conditions in the United States have continued to fall into line with a soft landing scenario. Last week's easing was well-previewed and well-justified.

As always, the Fed's decisions will be based on data and expectations of future developments. As we discussed in our post-election analysis, the Republican platform (if implemented to the fullest) is likely to result in higher growth, higher inflation and larger budget deficits in the medium term.

All of those things will tend to place upward pressure on interest rates. Markets have made substantial changes to their collective expectations for Fed policy: the implied overnight rate for the end of 2025 has risen by almost 100 basis points in the last six weeks.

Fed Chairman Jerome Powell was asked several times in his post-meeting press conference about the influence of the election on the potential path of Fed policy. He deflected all of them deftly, pausing only to repeat his belief that U.S. fiscal policy is on an unsustainable path. He also responded tersely to questions about whether the President has the right to dismiss the Fed leader.



Current Federal Reserve Board of Governors

Member	Term Expiration
Adriana Kugler	January 2026
Jerome Powell	May 2026 (as chair) January 2028 (as a governor)
Christopher Waller	January 2030
Michael Barr	July 2026 (as vice chair) January 2032 (as a governor)
Michelle Bowman	January 2034
Philip Jefferson	September 2027 (as vice chair) January 2036 (as a governor)
Lisa Cook	January 2038

Sources: Bloomberg, Federal Reserve

With new appointments, the Fed's monetary and regulatory posture could gradually shift.

Fed officials will be updating their forecasts in the coming weeks. The outcomes will be amalgamated and released at the conclusion of the central bank's next meeting on December 18. It will be very interesting to see whether the potential policy changes color the outlook, or the perceptions of risks to inflation and employment.

The Fed is also a primary regulator of banks. The incoming administration will likely take a lighter touch in this area; the Fed did so in 2018 at the direction of Randal Quarles, who Donald Trump had nominated. The lead supervision position on the Board of Governors will open in mid-2026.

As we noted in our recent defense of Fed independence, the tone of monetary and regulatory policy will change gradually with new appointments to the Fed. Governors rarely serve out their full 14-year terms, so openings are likely. Unlike Trump's first term, when a Democratic Senate blocked one candidate, White House appointments may get a smoother path to approval this time around. Until those roles open, however, friction between the White House and the Fed is likely to intensify.

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