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Investment Institute Macroeconomics

U.S. 2024 presidential election preview: Trump faces new adversary

The state of the race and what different outcomes could mean for the economy and markets

Macroeconomic Research

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Key points

- President Joe Biden ended his bid for re-election and endorsed Vice President Kamala Harris. The outlook for Harris is more uncertain, but on balance, we consider a Trump victory in November the most likely.
- Trump would likely focus on tariffs, tax cuts, migration, and deregulation. His win could also raise concerns around geopolitics – all of which would mean growth headwinds.
- Harris would likely adopt Biden's blueprint to focus on partial tax cut extensions and deficit reduction with a milder migration clampdown. An opposition-led Senate would likely impede the passage of such an agenda.
- The Federal Reserve would likely ease policy less under Trump and may implement a softer regulatory regime.
- Trump's agenda would likely boost the dollar and yields in the short-term but is ambiguous to risk assets. Further ahead, it suggests a weaker dollar, bonds, and risk assets.

Trump gains from Democrat uncertainty

Former President Donald Trump had been enjoying a lead in the polls, albeit a small one for many months. However, his lead increased after June's televised debate raised further concerns about President Joe Biden's fitness for re-election. After weeks of soul-searching, President Biden announced he would not stand for re-election and endorsed Vice President Kamala Harris. This was no coronation, but with Democrat heavyweights quickly joining in to also endorse Harris, Democrat hopes to avoid a messy selection seem to have been met, with Harris the likely nominee. Polls conducted immediately after showed Harris doing slightly better than Biden – even leading Trump in one poll. But we are cautious of whether such early polling will persist and on balance consider the likelihood of Trump regaining office as most likely, while acknowledging that Harris' entry makes this less certain.

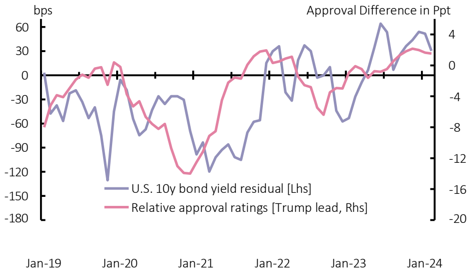
If Trump secures victory, we envision an economic agenda based on tax cut extensions, tariffs, migration, and deregulation – and all will be influenced by geopolitics. We expect Harris to maintain the current administration's continuity and broadly follow the same economic agenda as Biden, namely, to try to implement a partial tax cut extension, deliver some fiscal consolidation, and enact a less severe clampdown on migration. Yet Harris would likely face a Republican majority Senate, curtailing passage of legislation. We expect a Trump Presidency would create a modest headwind for growth next year, growing to a more meaningful interruption in 2026.

In terms of monetary policy, the Federal Reserve (Fed) is unlikely to be swayed by the election's timing. However, we believe the Fed would likely maintain more restrictive monetary policy under Trump in 2025 but would expect it to have to ease more materially beyond 2026 to offset growth concerns. We would also expect Fed Chair Jerome Powell's term to end in 2026 under Trump – with a newly appointed Chair more open to reviewing regulatory oversight.

We also consider the potential impact on financial markets. Trump's higher net approval ratings have boosted the dollar and Treasury yields. We show this for the dollar (Exhibit 1) but provide a fuller analysis considering different asset markets, including the dollar (click here to proceed directly to this section). We argue these asset classes could move further in this direction if Trump were re-elected. However, we are more ambivalent for the potential impact on risk assets, particularly equities. We also expect that over the medium term, this dynamic is likely to shift to a weakening outlook for the dollar, bonds, and equities.

Exhibit 1: Trump's approval lead boosts 10-year UST yields

U.S. - Relative approval ratings and U.S. 10-year yield model residual



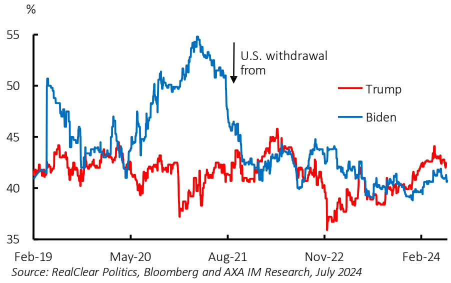
Source: Refinitiv and AXA IM Research, July 2024

TV debate changed everything

For months, polls had suggested the upcoming November election was the re-match no one wanted. Two candidates, both well known, both with low personal approval ratings, had seen broadly steady polling for most of this year (Exhibit 2). However, the first televised debate between Biden and Trump changed that outlook. Democrats had hoped to capitalize on Trump's recent conviction and get ahead of concerns about Biden's acuity. Yet during the event, Biden's faltering and stumbling performance eclipsed Trump's stream of factual inaccuracies. Trump saw a modest bounce in the polls. But the damage done to Biden, already amid concerns of his acuity, was fatal. On July 21st,almost one month after the debate, he pulled out of the race and endorsed Vice President Kamala Harris.

Exhibit 2: Trump had enjoyed small poll lead over Biden

U.S. - Overall approval ratings



Source: RealClear Politics, Bloomberg and AXA IM Research, July 2024

At the time of writing, Harris is not yet the Democrat nominee. Biden's endorsement was not a coronation and in the days that have followed a debate has arisen as to whether anyone else would stand. A nominee (and running mate) needs to be announced by the Democrat convention (August 19 –22). However, the nomination looks likely now to be agreed by virtual roll call ahead of the convention at any point between August 1 – 7. With time short to present a new nominee to the U.S. public and the need for Democrat unity to beat Trump, Democrats have been wary of a drawn-out contest in an open Convention. But they are equally keen to deliver a legitimate candidate.

Biden's endorsement of Harris was quickly followed by senior party officials including the Clintons, Nancy Pelosi, Elizabeth Warren, Alexandria Ocasio --Cortez, and Gavin Newsom (himself considered a potential contender). These have been quickly followed up by support from JB Pritzker and Gretchen Whitmer – other potential candidates. Moreover, the Associated Press stated that Harris' pledged delegates at the convention had already exceeded the 1,976 votes required to secure the

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nomination at the first round.[1] This all suggests Harris has sufficient backing to comfortably win the nomination – and deter anyone from standing against her. With her nomination all but secured, all that remains is to choose a running mate, which is likely to be someone from a battleground state.

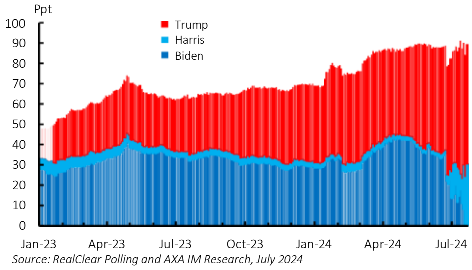
Polling had continued to lean marginally towards Trump at a national level and more so since the televised debate. But it is now too early to expect polls to provide a reliable steer. Despite four years as Vice President, few in the U.S. have a full picture of Harris and none will have answered polling questions with her as the Democrat nominee. As such, we can expect polling to be volatile around Harris over the coming weeks.

However, for now Exhibit 3 illustrates how betting markets recorded a sharp up-tick in Harris' favor – but still lean towards Trump overall.

[1] Associated Press (7/23/24): AP survey shows Kamala Harris backed by enough delegates to become Democratic nominee

Exhibit 3: Harris jumps in betting outlook

Biden, Harris and Trump betting probabilities



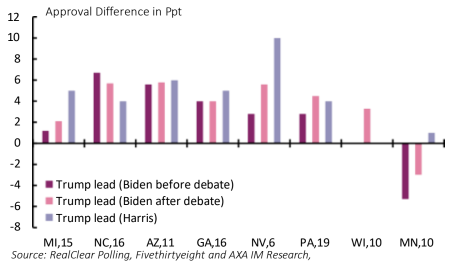
Source: RealClear Polling and AXA IM Research, July 2024

Exhibit 4 illustrates Trump's lead in swing states against Biden (before and after the debate) and the preliminary polling for

Harris. This suggests only marginal changes in most states, excepting more significant changes in Michigan and Nevada.

Exhibit 4: Trump's swing states lead holds in early Harris polling

Trump lead against Biden/Harris



Source: RealClear Polling, Fivethirtyeight and AXA IM Research,

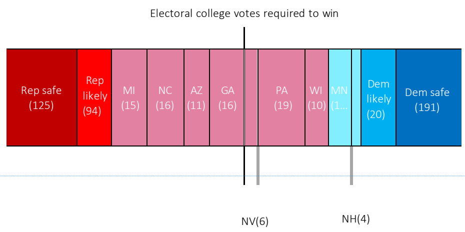
Exhibit 5, shows how this currently translates to electoral college votes, with current polling still showing Trump leading in sufficient swing states to win.

We had argued that polling would only become useful after the first televised debate as the public really focused on November's choices. With Harris still something of an unknown quantity, this is likely to be the case in the run into the second televised debate scheduled for September 10th. We suggest that we will only get a clearer picture from the polls after this.

In the absence of reliable polling data, we consider the prediction method of American historian Allan Lictman who has modeled elections going back to the civil war and predicted the correct outcome in "nearly" every election since 1984. He identifies 13 factors – or keys – to the race. If the incumbent party misses six or more, his system predicts a change of governing party. Incumbency was one of these, which now Biden has stepped aside is one miss. Other factors are factual, including the state of the economy (recession; real per capita GDP growth). After Biden stepped aside, Lichtman said of his own outlook: "There are four shaky keys that I haven't decided and I haven't made a final prediction yet."[2]

Exhibit 5: Trump still on track to electoral college victory

States with electoral college votes ranked by current polling



Source: RealClearPolitics and AXA IM Research, July 2024

One such "shaky" factor is the importance of a third-party candidate, Robert Kennedy Junior. Kennedy currently polls at less than 10% of the vote and will not win. But he could impact Trump's or Harris's vote share. Indeed, while third parties are traditionally viewed as splitting the Democratic vote, in this race Kennedy's conspiracy-theory style image has been more attractive to Trump's voter base than Democrats. Whether he stays in the race could be the key to a still large block of votes. It also influences the balance of Lichtman's analysis and while he has not come to a conclusion, our assessment of his criteria points to a Trump win if Kennedy stays in the race.

On balance, we now consider a Trump Presidency as the most likely outcome, but readily acknowledge that Harris' participation makes this less certain in our minds than with Biden. Given this ongoing uncertainty, in our analysis we consider a range of alternatives.

Either way Congressional outcomes will be important. The Senate currently stands at 48 Democrats with independents who caucus with Democrats, against 49 Republicans. It will re-elects 34 of its 100 seats this election, including a special election in Nebraska. Of those, 23 are Democrats, increasing Democrat re-election risk, notably with West Virginia (Democrat Senator Joe Manchin's old seat) looking likely to swing to a Republican. Pollsters 270toWin currently suggest 50 Senate seats are at least leaning to Republicans, with two

Commented [AH2]: Formatting note - include the below in the same paragraph break.

[2] Fox News (7/21/24): Presidential predictor Allan Lichtman tells Democrats after Biden drops out: 'Get smart and unite

states, Ohio and Montana, currently considered "toss-ups."[3] The Senate looks likely to return a Republican majority.

The House of Representatives has in most elections gone with the Presidential vote. This time some redistricting appears to

[2] 270toWin (July 2024): 2024 Senate Election Forecasts

add to the Democrats' favor, and current polling suggests this is in "toss-up" territory. We conclude that if Trump wins, he is likely to preside over a narrow majority in the House, but if Harris wins, she will likely have a majority.

Trump 2.0: Demand-side ease, supply-side squeeze

Based on the above, we consider the most likely scenario to be a second term for Trump, with majorities in both houses of Congress. This would grant him leeway to pass legislation. Trump has not laid out a manifesto, per se. However, during his campaign he has discussed a number of aspects we think will form the core of his economic agenda. This is likely to follow five themes: tax cut extensions, tariffs, migration policy, looser regulation, and geopolitics. That said, it is a matter of judgement to what extent any of these policies will be implemented with Trump himself suggesting a wide range of possibilities.

Fiscal policy

Trump's first-term landmark legislation was the Tax Cuts and Jobs Act (TCJA) 2017 tax cut package. This was passed using the reconciliation process, which requires budget neutrality over a 10 -year timeframe and so tax cuts were scheduled to expire – revert to pre-2017 rates – within a decade. These expire by the end of 2025. Trump is highly likely to extend these cuts. The Congressional Budget Office (CBO) estimates such an extension would cost $4.6tn over 10 years (an average of 1.3% of GDP per annum).[4]

It is likely a Trump administration would suggest financing for some of these extensions – we consider the impact from tariffs below. But we think it likely that the CBO's assessment of the net impact would be to increase the budget deficit further, which we think will be a problem. The CBO currently projects a deficit of 6.7% of GDP in 2024, falling to 5.5% by 2027 but rising back to 7.1% by 2033 – an average deficit of 6.3% of GDP over the coming ten years.[5] A further increase in the deficit from partially unfunded tax giveaways would add to this already eye-watering fiscal shortfall and risk raising concerns about fiscal sustainability.

Protectionist tariffs

Trump's first presidential term was characterized by the imposition of tariffs on a number of trade partners. His campaign speeches suggest a return to protectionism if he wins a second term. Trump has suggested many possible variants, including a 10% blanket tariff; a 60% tariff on China; and reciprocal tariffs – imposing the same tariffs on countries as they impose on the U.S. Their impact would range from a 4.5 – 8.5ppt increase in the U.S.'s weighted average tariff, compared to the 1.5ppt average tariff increase in his first term. [6] More recently, focus has narrowed to the 10% and 60% combination, but even then, uncertainty remains as to how current trade partners, including Canada, Mexico, Korea, and Japan, would fare in this regime, retaining significant uncertainty over implementation.

Tariffs have two major impacts. First, they raise prices. The exact impact depends on the characteristics of individual products, determining how much external producer profits fall and how much gets passed on to the consumer. One study estimated the 2018 tariffs increased U.S. manufacturing prices by 1ppt[7]; another said there was a near 100% pass-through to U.S. consumers.[8] The increase in imported goods prices creates a substitution effect – consumers switch purchases from a targeted product to other imported or domestically produced goods, the latter benefit to domestic producers being one of the touted benefits of the system. But the consumer is worse off being priced out of their first choice.

Second, they raise government revenue. With U.S. imports totaling $3.1tn[9], it is tempting to see a 5ppt increase in the total tariff rate as generating $150bn plus of per annum revenue and this may guide a new Trump administration's estimates of revenue increase. However, tariffs also alter behavior and do not generate the revenues that previous consumption patterns suggest. One study suggests even a hypothetical 70% tariff rate would deliver only $560bn of revenues, not the $2tn implied in an all-else-unchanged calculation, after allowing for shifts in consumer purchases and noncompliance.[10]The Peterson Institute estimates that 60% tariffs on China and 10% on the rest of the world (including trade partners) would raise $2.75tn in a static analysis – not allowing for the impact of slowing economic activity.[11]The Committee for Responsible Federal Budget (CRFB), published two reports suggesting total tariff revenues of around $2.2tn, allowing for slower economic activity – less than half the estimated cost of expected tax cut extensions.[12]

Moreover, across-the-board tariffs are regressive – they weigh proportionately more on lower-income households that spend a greater proportion of their income on goods than higher income households. It is therefore an irony that populists often tout trade protectionism because it defends domestic jobs. In

[4] CBO (May 2024): Budgetary outcomes under alternative assumptions about spending and revenues

[5] Congressional Budget Office (6/18/24): Congressional Budget Office Updates Baseline: Deficit Spending is 27 Percent Higher Than Previously Estimated

[6] AXA IM Research, August 2024

[7] Journal of Economic Perspectives (August 2019): Amiti, M., Redding, S.J. and Weinstein, D.E.,The impact of the 2018 tariffs on prices and welfare

[8] Cato Institute (April 2024): York, E., Separating tariff facts from tariff fictions

[9] Tariff Tracker (6/26/24): Tracking the Economic Impact of the Trump-Biden Tariffs

[10] Tax Foundation (June 2024): York, E., Five things to know about Trump's tariff and income tax proposals

[11] Peterson Institute (May 2024): Clausing, K. A. and Lovely, M. E., Why Trump's Tariff Proposals Would Harm Working Americans

[12] Committee for a Responsible Federal Budget (9/11/23): Donald Trump's Universal Baseline Tariff

reality, what is being proposed is a tax imposed largely on lower-income Americans to pay for extensions to tax cuts that disproportionately benefit higher-income Americans.

Migration

Trump would also likely clamp down on immigration. The CBO estimated immigration rose to 3.3 million in 2023 and monthly data to June suggests this will be similar this year (flows in H1 2024 were only 3.2% lower than the same period in 2023). [13] Again, Trump has been rhetorical rather than specific in this area. However, this time a focus appears as much on deportation as on reducing incoming flows. Trump has referred to similar efforts by President Dwight D. Eisenhower in 1954 – where hundreds of thousands of undocumented Mexicans were deported. He also looks to expand the "expedited removals" process. In total, this suggests millions could be targeted.

More recently, Trump proposed allowing all U.S. college graduates a Green Card for permanent residency (once vetted). In 2022-23, the number of international undergraduate and graduate students totaled over 800k.[14]This still suggests an outright contraction in migrants, with targeted deportees likely exceeding new graduate Green Cards and a sharp skew towards skilled immigration from unskilled. All of this is in sharp contrast to strong migration in recent years and labor supply accelerated to average an annual near 2% in 2022-23, reflecting increasing labor force participation in 2022, but increasingly immigration in 2023.[15] This acceleration should have raised the non-inflationary growth rate of the economy by a similar 1ppt. Trump's policies suggest the prospect of attenuating that growth rate (albeit potentially somewhat offset from higher productivity growth associated with higher-skilled workers).

Regulation

We would also expect a Trump administration to continue to focus on deregulation. This would likely be across the board but would have specific focus on the oil and gas industries, particularly rowing back on efforts to prevent climate change, including with some possible adaptations to the Inflation Reduction Act (IRA), banking, and artificial intelligence (AI).

While it is not obvious this would have a medium-term benefit, we suspect it would deliver a number of sectoral boosts, which might add to an overall easing in financial conditions.

Geopolitical drivers

A final consideration is what a second-term Trump Presidency would mean for geopolitics and the global economy. The U.S. President can have far-reaching implications for the globe, but we consider three areas foremost. First, Trump alludes to ending the Russia –Ukraine war and advisers appear to be pushing towards an initiative to cease providing U.S. weapons unless Kyiv enters peace negotiations based on prevailing battle lines.

Second, we expect rising trade tensions with China. Third, Trump has been uncharacteristically reserved over plans regarding Israel and Gaza, but this situation remains delicate in terms of avoiding the conflict's spread to a more regional one. It is difficult, at least at this stage, to suggest what might happen in each of these cases but pursuit of the above agenda would likely raise global concerns and tighten financial conditions.

Summary of Trump's economic agenda

Trump would likely implement his agenda relatively slowly: migration and trade measures would probably impact first starting in 2025 alongside some geopolitical developments. We expect fiscal measures not to impact materially until 2026. As such, we envisage a modest headwind to 2025 GDP growth – estimating a drag of around 0.7ppt, a combination of slower labor supply growth and some tightening in financial conditions associated with geopolitical concerns, somewhat offset by sectoral boosts from deregulation. However, we see a bigger growth drag in 2026, reflecting a full year of migration policy slowing labor supply growth, an economic impact from tariff increases and a negative overall impact from fiscal stimulus (Exhibit 6). This last point reflects our view that further tax cuts are likely to have a low fiscal multiplier – taxes will not be lowered, just not increased. Moreover, we also expect financial markets to react negatively to a further deterioration in the fiscal deficit. If tariff revenue is the only source of financing for tax extensions, the shortfall could average $240bn per annum over 10-years, around 0.75% of GDP, lifting the deficit to around 7% of GDP per annum over the next 10 years.[16] A negative market reaction could be meaningful, although we acknowledge significant uncertainty around this reaction. However, this concern was echoed recently by Former Treasury Secretary Lawrence Summers who warned that Republicans "are setting up the U.S. for a kind of Liz Truss moment"[17] – referring to the ex-UK Prime Minister whose financial plans delivered such a shock to financial markets.

One caveat remains that if Trump were elected but failed to secure a majority in the House, it would be difficult to enact aspects of the above. Migration control and most of the tariff policy could largely be enacted by Executive Order. However, the fiscal plan would be more difficult – Trump could be stalled in the same way Biden has been. This would create a stand-off with the default legislative outcome a fiscal cliff where all tax cuts expire delivering a growth hit of around 1.25% in 2026.[18] In this outcome, the White House would likely need to include more funding measures to facilitate extension, which could mitigate the downside risk

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[13] Congressional Budget Office (January 2024): The Demographic Outlook: 2024 to 2054
[14] Best Colleges (12/18/23): International Student Enrollment Statistics
[15] AXA IM Research, August 2024
[16] AXA IM Research, August 2024
[17] Bloomberg News (7/24/24): Summers Says GOP Fiscal Plans Set US Up for 'Liz Truss Moment'
[18] AXA IM Research, August 2024

of negative market reaction to further fiscal loosening. That

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said, a Democrat House would also need to compromise to avoid being blamed for delivering a fiscal cliff of full expiry. On balance, we would see the above estimates as the upper limit of the impact in this scenario but expect something less severe.

Exhibit 6: Estimated economic impact of Trump's agenda

GDP impact (ppt deviation from no change)				
Policy area	2024	2025	2026	2027
Migration		-0.4	-0.85	-0.45
Fiscal (TCJA extension)			0.4	0
Fiscal (IRA repeal)				
Fiscal (reaction to deficits)			0 to -1	
Regulation				
Tariffs			-0.25	0
Geopolitical		-0.2	-0.2	
GDP total	0	-0.6	-0.9 to -1.9	-0.45

Source: AXA IM Research, July 2024

Harris' economic agenda: Thwarted deficit reduction

Much as we expect Harris to identify with the current administration's economic successes, we also expect her to follow the broad economic agenda already set out in the President's Budget for Fiscal Year 2025. Moreover, she would likely face several similar choices to Trump in terms of managing

migration and tax cut expiries. In other areas, such as geopolitics, it is difficult to judge how things would develop, but we see no priori reason for the status quo to change and hence do not factor in any impact to our economic outlook on this front.

Managing tax cuts and deficit reduction

The President's Budget Fiscal Year 2025 stated that a Biden administration would also not allow all of the TCJA tax cuts to expire but differs from the Trump approach in two key aspects. First, it would limit the extension of tax cuts only to non-high

earners, broadly applying to those earning less than $400k ($450k joint incomes). Second, it would fund this with a series of tax increases, not tariff revenues, some a partial unwind of the 2017 tax cuts, others with new taxes. This proposal is a bold series of large adjustments, that would not only significantly adjust the outlook for the U.S. finances at a headline level but would deliver an even bigger readjustment to the distribution of tax and spending across income levels and for business.

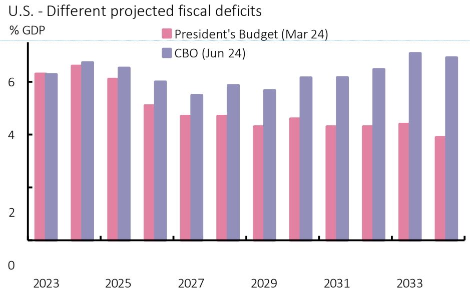
From a business perspective, this would include raising the corporate tax rate to 28% from 10% (although still below the pre-TCJA rate of 35%); increasing the tax rate on U.S. multi-national companies (MNC) to 21% from 10.5% (to reduce incentives for tax inversion); and raising the minimum tax rate to 21% – in line with this MNC tax rate – from 15% at present. It would also raise the surcharge on stock buy-backs to 4% from

For higher-income individuals, the budget sets out to remove deductions on executive pay; introduce a minimum 25% "billionaire's tax"; end TCJA tax cuts for individuals earning over $400k (single income)/$450k (joint), with the rate reverting to 39.6%; increase the Medicare tax rate to 5% from 3.8% for those earning above $400k; and to tax capital gains at income tax levels for those earning in excess of $1mn. These measures are estimated to additionally raise over $2tn over the decade.

The net impact of these measures would be to lower the deficit, even allowing for continued lower tax rates for non-high earners and including other measures, such as the child tax credit. This would be compounded by the impact of lower debt interest (estimated at around $0.4tn). We estimate this would create a marginally stronger fiscal headwind to the economy in 2025 than in the CBO's current baseline and more so in 2026 (Exhibit 7). However, such a tightening would likely be offset by a faster pace of Fed monetary policy easing. And the improvement in the fiscal outlook – the Budget estimates the deficit would shrink from an average shortfall of 5.8% (2026 – 2031) to an average 4.7% and be on a declining trend by the end of the next 10 years – should support a reduction in term rates, further offsetting headwinds to growth.

Exhibit 7: Deviation from economic conditions not around elections

U.S. - Different projected fiscal deficits



1% currently. In total, the budget estimates these measures would raise just over $2tn over the next 10 years.[19]

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[19] AXA IM Research, August 2024

Source: Office of Management and Budget (OMB), CBO and AXA IM Research, June 2024

Yet, an incoming Harris would not likely enjoy a Senate majority. This is likely to hamstring key legislation – including the significant tax and spend adjustments proposed in the Budget. The President's Budget is highly unlikely to be accepted in its current form, creating a similar stand-off as in the Trump
mixed-Congress scenario. In this scenario, Democrats would have to seek compromises to balance extending some taxes with spending restraint or borrowing increases, rather than tax increases to pass legislation. This will be difficult, but a Republican Senate would also face some pressure to concede ground with the default, no compromise fiscal cliff for 2026.

Southern border needs to be addressed

We also assume Harris would introduce a variation of border control similar to the bipartisan Senate bill proposed this year and blocked by Republican House members. Harris' expected lack of

Congressional control will again be a factor. However, with expected control of the House, she should be able to pass this year's bipartisan Senate proposed bill back to the Senate, which we assume would pass in a post-election (post-Trump) environment.

This proposal would also slow migration and hence labor force growth. It stated that migrant deportations could begin if inflow exceeded 4,000 per day over a week and was mandated if it exceeded 5,000 a day over the same period (or 8,500 on any one day). This would defacto accept migration of up to around 1.5mn per year, less than half the present pace. President Biden subsequently announced an Executive Order to cease all inflow if migration reached 2,500 per day until the flow fell below 1,500. This would restrict the migration inflow to around 750k – roughly half the Senate bill proposal. But we suspect that Harris would revert to the Senate bill, which should garner sufficient support after the election to be a guide to policy. We estimate this would slow labor supply growth from the 1.7% for full year 2023, to around 1%, still above our expectations for Trump's policy.

First-term continuity

Exhibit 8: Estimated economic impact of Harris' agenda

U.S GDP impact (ppt deviation from no change)			
Policy area	2024	2025	2026
Migration		-0.2	-0.4
Fiscal (TCJA extension)			0.2
Fiscal (IRA)		0.2	0.2
Fiscal (reaction to deficits)			
Regulation		-0.1	-0.1
Tariffs			
Geopolitical			
GDP total	0	-0.1	-0.1

Source: AXA IM Research, July 2024

Finally, a Democrat administration would likely continue to oversee the implementation of the CHIPS and IRA Acts. This looks to have boosted foreign direct investment by around 0.3% of GDP and lifted overall private investment, a tailwind that we expect to continue over the coming years.[8] We estimate this to be a modest positive for the economy over the coming two years. Moreover, despite Biden initiating tariffs in May on Chinese products, we do not expect Harris to extend these tariffs in a meaningful way and the tariffs announced to date – covering $18bn worth of Chinese goods – only accounts for 4% of China's imports to the U.S. and 0.5% of total U.S. imports. That said, although Biden's first term may not have included tariffs, it did step up sanctions against China, something that we would expect to continue to remain an active policy. By comparison to Trump's expected trade policy, we expect a negligible impact on the growth outlook (Exhibit 8).

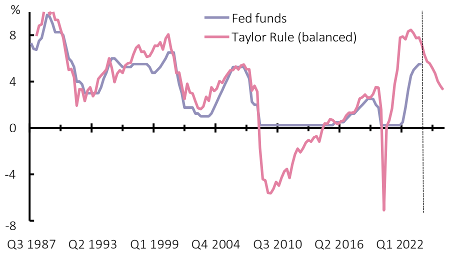
Implications for the Federal Reserve

Different electoral outcomes will likely lead to different policy paths for the Fed. However, in the short term, it will not be influenced by the timing of the election itself. This is contrary to persistent Fed folklore which suggests it adjusts its behavior during election cycles, not wanting to raise/cut rates prior to elections for fear of showing favoritism to one or the other candidate. We show that there is no statistical evidence of this behavior over the past 40 years. We then consider the impact of various electoral outcomes on Fed policy.

We propose that the Fed adjusts monetary policy according to economic conditions at all times. Exhibit 9 shows how Fed Funds policy since the late 1980s has moved broadly in line with Taylor Rule prescriptions,[9] which in turn are a function of inflation, GDP growth rates and the underlying neutral rate.[10]

Exhibit 9: Fed policy moves in line with economic conditions

U.S. Monetary policy and a Taylor Rule



Source: Bookings Institute, Federal Reserve Bank (FRB) and AXA IM Research, July 2024

Exhibit 10 illustrates the deviation of actual policy from Taylor Rule estimates (excluding the quantitative easing (QE) period after 2008). The mean deviation of the pre-election quarters (Q3 and Q4) in any election year is not statistically significantly different from the mean of the whole,[11] suggesting Fed behavior has not altered around previous election cycles. We do not expect it to now.

That is not to say the election will not influence policy: financial conditions are likely to shift according to changing expectations for the election outlook. But on balance, we do not think this

[8] Page, D., "Will the US presidential election endanger an investment boom?", AXA IM Research, 20 May 2024
[9] The Taylor Rule indicates how central banks should move interest rates to account for economic conditions such as inflation
[10] We note there are clear periods of divergence. Post-global financial crisis, this reflected actual policy being constrained by the zero lower bound and justified the period of unconventional monetary policy and QE. We also note divergence over the more recent pandemic.
[11] T-test and Z-tests produce results of 0.93 and 0.82, with a value of <0.05 required to suggest a significant difference between the two points.

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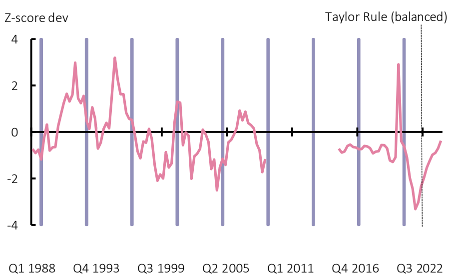
will affect our forecasts for 2024 – we expect the Fed to ease monetary policy by 25bps in September and December. But the outcome of the election is likely to have a more meaningful impact for next year and beyond.

Our two main case alternatives, a baseline of a Trump win (with a united Congress) and the main alternative for now, a Harris win (with a split Congress), would likely deliver different monetary policy paths to the otherwise smooth drift neutral that markets pencil in over the coming years as the economy achieves a soft landing.

Exhibit 10: No additional deviation in policy rate from economic conditions around elections

U.S. - Z-score deviation from Taylor Rule



Source: AXA IM Research, July 2024

In the short term, a Trump win is likely to generate a higher inflation outlook, directly through tariffs and indirectly through migration controls – both are negative supply shocks. While we expect growth to slow, the current disinflationary trend is unlikely to continue as smoothly. We would expect the Fed to be more cautious of rate cuts through 2025 in the face of these developments, subject to any parallel tightening in financial conditions as markets anticipate such events (higher yields and the dollar). As the combination of these factors persist, and depending on the scale of any tightening in financial conditions precipitated by increased concerns around fiscal stability, we see the risk of a more material growth shock further out, which would then force the Fed to cut rates more materially in 2026.

In this scenario, we would forecast the Fed cutting rates only twice next year (to 4.50%), but then having to ease policy more substantively through 2026.

In the case of a Harris win (with a united Congress) plans for a methodical tightening in fiscal policy, while a greater headwind to growth, could be mitigated by the Fed easing monetary policy more quickly. However, we estimate that Harris' policy package would deliver only a modest additional headwind to growth over the coming two years, including a sharper

deterioration of supply-side factors through his own migration policy. We suggest this would see the Fed ease policy four times in 2025, with no strong directional outlook for 2026.

However, as stated, we consider a Harris presidency as likely to come only with a split Congress. This would likely see a compromise that would see less fiscal retrenchment (and redistribution) and could still threaten more borrowing. This could again stoke concerns about inflation and the Fed might only ease policy three times in this event in 2025.

Beyond monetary policy, the election impact on the Fed is likely to focus on regulation. We would not expect a Harris administration to attempt to influence the Fed's regulatory oversight. However, we do see the risk that a Trump Presidency would seek to pressure the Fed over its implementation of global Basel III rules over the next Presidential term.

A broader question would be how a Trump Presidency might

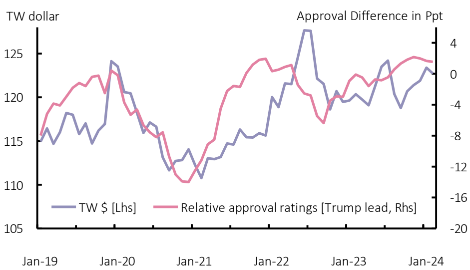
seek to influence the Fed. Despite fears, we do not expect any overt institutional changes to Fed operations. However, we do think that under a second Trump term, Powell would be replaced when his term expires in May 2026 with a more sympathetic Chair. We do not think that this would influence monetary policy, despite Trumps expressed desire for lower rates – we believe appropriate fears of financial market reaction to overt policy interference would preclude this. But, this might facilitate a more government-friendly regulatory approach.

Market implications

We expect a Trump victory to deliver a stronger dollar in the short term with both the expected tariff policy and fiscal loosening something that economic theory suggests should boost the dollar, all else being equal, while our expectation that these policies make Fed monetary policy easing less likely should also impact. Exhibit 11 shows how the trade-weighted dollar has indeed tracked Trump's positive net approval ratings over recent years, suggesting the market shares a similar assessment. The assessments below are Trump's poll lead against the presumed Democrat nominee, Biden. Looking ahead, we will continue such an assessment with Trump's lead over Harris.

Exhibit 11: Trump gains appear to boost dollar

U.S. - Relative approval rating and trade-weighted dollar



Source: Refinitiv and AXA IM Research, July 2024

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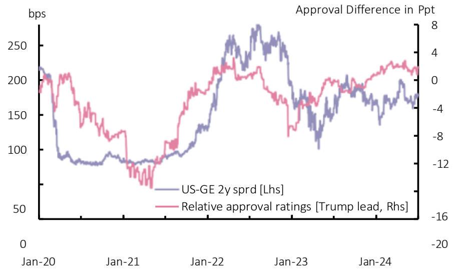
Similarly, expectations of fiscal loosening and supply-side restrictions suggest a more inflationary outlook that we think will dampen the Fed's ability to loosen monetary policy. So, we would expect the U.S. rate outlook to be higher with greater expectations of a Trump Presidency. Exhibit 12, illustrates the

U.S. 2-year yield spread over the German yield appears to suggest such a correlation.

Exhibit 12: Trump gains also appear to underpin rate outlook
U.S. - Relative approval rating and US-GE 2y

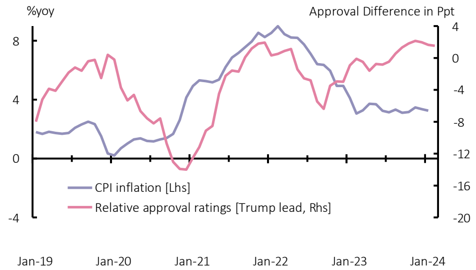


Source: Refinitiv and AXA IM Research, July 2024

However, financial markets are affected by a range of factors, not just the political climate. We also note that in the above our measure of political appetite – net approval ratings – is directly

affected by one of these factors, namely inflation. Exhibit 13, illustrates how the surge in inflation boosted Trump's net approval rating, by severely impacting Biden's approval. This effect has faded with inflation. However, because inflation also directly impacts financial instruments for a variety of reasons, it probably accounts for much of the apparent correlation above.

Exhibit 13: Cost of living crisis spills across measures
U.S. - Relative approval ratings and CPI inflation

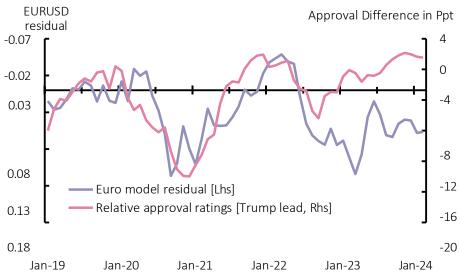


Source: Refinitiv and AXA IM Research, July 2024

To account for this, we consider the political momentum against financial instruments only after controlling for other common factors, including inflation. Exhibit 14 illustrates the

residual and Trump's net approval rating, suggesting a Trump win would be positive for the dollar.

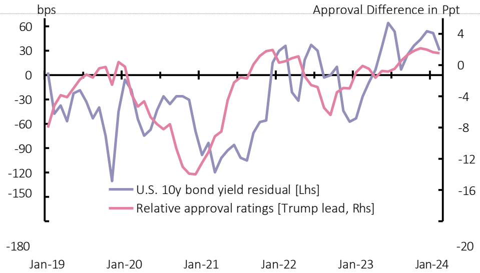
Exhibit 14: Trump gains support dollar versus euro
Relative approval ratings and Euro model residual



Source: Refinitiv and AXA IM Research, July 2024

Exhibit 15 shows a similar positive correlation between Trump's net approval and our 10-year U.S. Treasury yield model residual, which accounts for GDP growth, Fed rate, and balance sheet policy, Treasury issuance and bond market volatility. This also suggests that a Trump win would raise U.S. yields.

Exhibit 15: Positive correlation with 10-year UST yields
U.S. - Relative approval ratings and U.S. 10-year yield model residual



Source: Refinitiv and AXA IM Research, July 2024

Finally, Exhibit 16, considers the (quarterly) residual of our simple S&P 500 equity index model, accounting for inflation, GDP growth, and excess liquidity in the U.S. financial system, here we see no obvious relationship. Despite the surge in equities that followed Trump's election last time, this also concurs with our a priori assessment. Although we

residual from our euro-dollar model that explicitly accounts for differentials in growth, inflation, central bank policy rates, and balance sheets. After accounting for these factors, we can still see evidence of negative correlation between the euro-dollar

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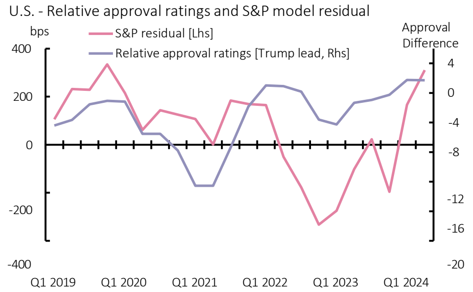
acknowledge that deregulation would once again likely provide a boost for certain equity sectors, we are not convinced the net effect of Trump's policies would be positive for these sectors, nor the index overall. This time, although we again envisage fiscal easing, we are wary that concerns about fiscal stability will tighten financial conditions and have a negative impact on equities overall.

As such, we conclude that further gains for Trump in the polls over coming weeks, and an eventual win for him in November, would likely drive the dollar higher – against the euro, but likely more broadly – and yields higher. However, we are more ambivalent about the outlook for risk, particularly if over the longer-term we consider Trump's policies as a headwind to growth, which could force the Fed to ease policy aggressively.

Exhibit 16: Trump and the S&P 500 index



Source: Refinitiv and AXA IM Research, July 2024

26 July 2024

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