PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS

Fiscal Risks from the US Election
A non-modal view

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PIIE Global Economic Prospects

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Fiscal Risks from the US Election

Modal forecast

- Clinton is elected President
- Senate has a small Democratic majority (<54 seats)
- House has a reduced Republican majority

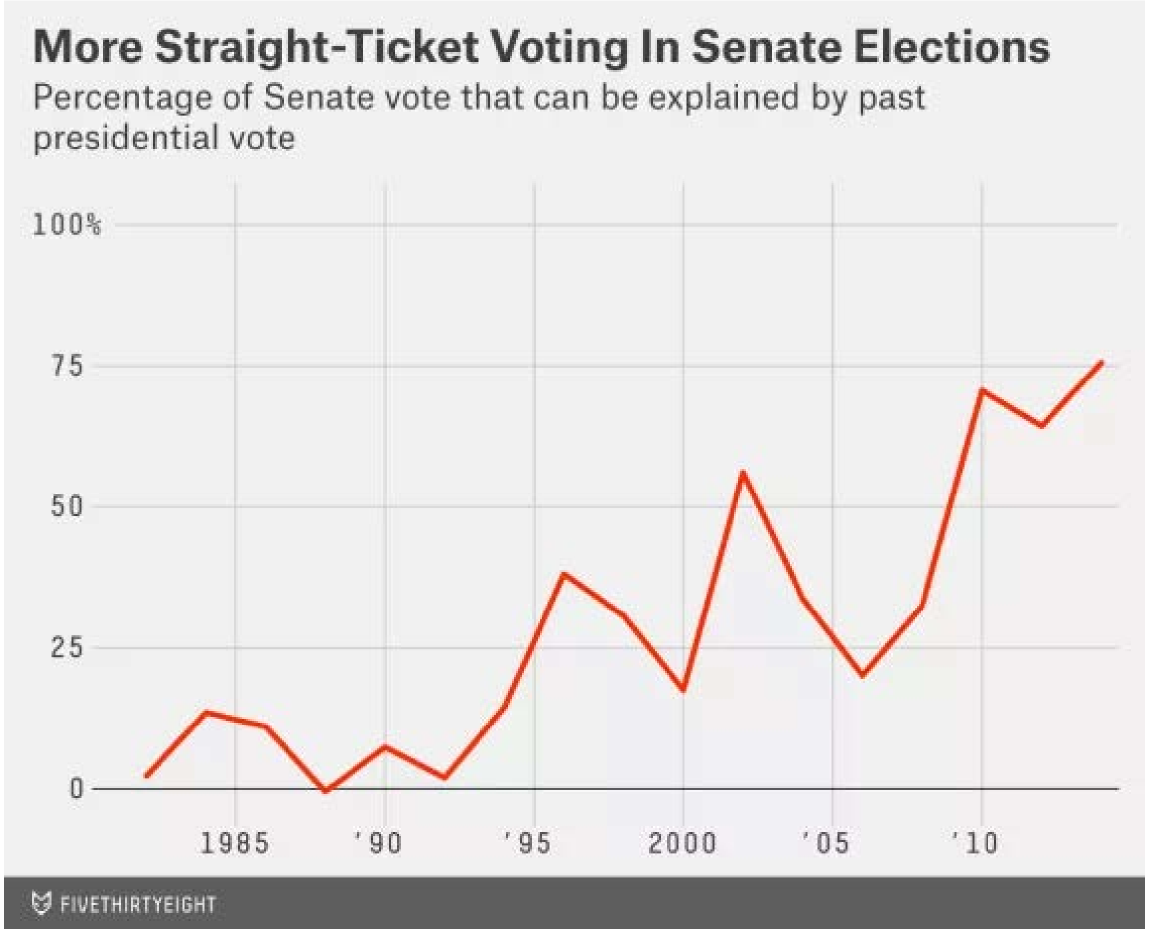
Policy result

- Continued budget deadlock
- Fiscal policy stays close to neutral
- Monetary policy stays on gradual hikes path
- Stockton economic forecast just given

Why not assume this outcome?

- Coattails are longest when POTUS election is uncertain (high turnout/low strategic voting) but clear victory margin
- Correlation between Senate/House and Presidential races has gone up
  - Polarization increases the correlation
  - There's no meaningful 3rd option for Congress
- Polling data on Trump support unreliable
  - White non-urban women are (the only?) swing voters; millennial turnout is the other variable

Polarization matters



Congressional majority outcomes

<u>Republican</u>

- Trump is elected president
- Senate has a small R majority
- House has R majority
- Enough D Senators scared into compromise + R use of reconciliation process
- Assume chance of Trump win >45% *(538 says 42.1%)* and 75% correlation for Senate *(538 says R senate 38.8%)*, then 30% chance this happens

<u>Democratic</u>

- Clinton is elected president
- Senate has a small D majority
- House has close to a D majority (gain 15+ seats)
- Enough R Congress scared to win back some non-white or business voters
- Assume chance of clear Clinton majority win 15% *(538 says 14.5%)* and coattails 2.5 seats/% pt margin, then 10-15% chance this happens

Implies nearly 40% Chance of Significant US Fiscal Stimulus 2017-18

- Both support infrastructure investment
- Clinton plan is largely fully funded, but if some compromise in House on tax hikes, can expect net stimulus of <0.5% GDP both years
- Trump plan is a huge budget blow out through unsustainable tax cuts, can expect net stimulus of >1.0% GDP both years
- Everyone assumes an increase in productivity/revenue, not a safe assumption

How does the Federal Reserve react?

- Assume clear majority of current FOMC believes economy at risk of overheating
- Fiscal stimulus sharply raises growth and inflation projections in the Trump scenario
  - Do they react to the long-term budget implications?
  - Do they assume further labor supply reduction?
- Trump trade measures temporarily raise inflation and puts upward pressure on $
- A remake of Reagan-Volcker worse than the original is the likely outcome

A Better Global Policy Mix by Accident?

<u>The coming fiscal push</u>

• China	~1.0% GDP
• Japan	>0.5% GDP
• Germany	~0.3% GDP
• UK	>0.7% GDP
• France	~0.5% GDP
• Italy	~0.3% GDP
• Canada	>0.3% GDP

- G20 right to call for switch from monetary to fiscal stimulus
  - Also right to do any public investment now, DUH
- Benefits of simultaneity are less leakage and lower currency impact
  - Higher multipliers
  - Could affect Y*/R*
- Best if sustained for two-plus years, however
- Would the likely (60%) 'responsible' Clinton fiscal policy outcome blow this global opportunity?