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The macro and market consequences of a second Trump administration

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Donald Trump's second presidency is likely to result in **lower US GDP growth**, **faster US inflation** and a slightly **higher path for the fed funds rate**. The implications for the rest of the world are highly uncertain, not least because it is unclear how many of the pledges he made on the campaign trail will translate into a programme for government. In general, however, we think the **immediate effects will be smaller** than many seem to fear. This is not to say that Trump's re-election doesn't matter – just that the consequences are unlikely to be found in changes to global GDP growth over the next year.

This will mechanically pull down global GDP growth and push up global inflation by the order of 0.2%. And the implications for other economies could accentuate these effects, although as we have previously pointed out, the impact will depend very much on how the reality compares to Trump's rhetoric.

We are minded to reduce our GDP growth forecast between H2 2025 and H1 2026 by roughly 1% and add 1% to our inflation forecast over the same period. We will also probably raise our fed funds rate forecast by 50bp, meaning that the low next year will become 3.50% to 3.75%.

Tariffs

Large US tariffs would hurt China's export sector, albeit less than many suppose. Exports of goods to the US are equivalent to less than 3% of China's GDP. Allow for an offset from the exchange rate, some tariff evasion and redirection of China's manufacturing output to other markets, and the impact of even a 60% US tariff on all goods from China would be well under 1% of its GDP. This could be more than offset by fiscal expansion.

- We estimate that the direct impact of a 10% tariff on all US imports would be only a **fraction of a percent of GDP for the euro-zone**, though it would be **bigger for Germany**.
- We think the **EU would retaliate** with tariffs of its own, but our working assumption is that they would be on the US only rather than universal - European policymakers would aim to limit the risk of a bigger lurch towards protectionism.
- Within the emerging world, a **10% universal tariff would hit Mexico hardest**, reducing GDP by around 0.5% or so.

Markets

In markets, we think Trump's policies are consistent with higher yields, a stronger dollar and continued strength in US equities. We think that on balance it is now more likely that the 10-year Treasury yield will remain around 4.5%, rather than fall back as we had anticipated. Meanwhile, whereas we had thought the dollar would weaken a little over the next year, it is now more likely that **the DXY index appreciates by 3-5% rather than weaken**. We continue to anticipate further increases in US equity prices, but may revise down our forecasts for equities in other major economies.

In particular, China and Mexico may see a larger negative impact from US tariffs.

Finally, Trump's re-election is unlikely to have a major bearing on commodity prices but, at the margin, adds to the downside risks facing oil over the next 3-5 years.

Perhaps the most important point to stress is that, for the rest of the world, the impact of a second Trump administration will extend beyond the effect on short-term macro variables such as GDP. **Trump's re-election will change the nature of US-China fracturing**, **re-centring it on tariffs** rather than tech controls. Those controls may become less effective if America alienates its traditional allies, giving Chinese firms breathing room as they try to overtake the West. It also raises the risk of a shift towards US isolationism, which would have significant consequences for economic and national security in US-aligned countries.

> **Most of all, the global policymaking environment will become more uncertain. In this sense, the world has changed.**

The macro and market consequences of a second Trump administration will depend to a large extent on the degree to which the policies that he campaigned upon make it through to a programme for government.

This is highly uncertain.

Assumptions about Trump administration policies

These remain highly uncertain, although in some areas (trade and immigration) there are good reasons to think they will be more extreme than was the case during the first administration while in other areas (fiscal expansion) they may be less so. Specifically, we assume that:

1. Tariffs on imports from China are increased to 60% and a universal tariff of 10% is introduced on all tariffed goods from other countries. We assume that the revenue from these tariffs is recycled through cuts in other taxes, so the net fiscal effect is neutral.

2. The original Trump tax cuts, which are due to expire at end-2025 are extended, but that there is no additional fiscal expansion.

3. Net immigration is reduced to near-zero and deportations of undocumented migrants reduce the US labour supply by 0.1-0.2%.

As we have noted, it remains to be seen whether these threats translate into policy or are used as bargaining chips in future negotiations. However, if they were enacted it would push the **average US tariff rate up from 2.5% to around 15%** from the middle of next year, with most of that increase falling on China. The impact on the effective average tariff rate may be somewhat smaller as imports from elsewhere replace those from China. Other countries would respond, but with less force.

Taken together, while some countries will be hit harder than others, the immediate effect of all Trump's policies on key global macro indicators could be surprisingly limited.

The overall impact on global trade of the tariff increases in our working assumption would be relatively modest:

- Global inflation might increase by something like 0.2%;
- Some EM central banks will scale back plans to ease monetary policy;
- We do not anticipate making significant changes to our forecast for interest rates in major DMs outside the US as a direct result of the US election outcome;
- The global economy is likely to expand by a little less than we previously estimated – perhaps by 2.8% in 2025 compared to our previous forecasts of 3.0%.

Trump's re-election will change the nature of US-China fracturing, re-centring it on tariffs rather than tech controls. Those controls may become less effective if America alienates its traditional allies, giving Chinese firms breathing room as they try to overtake the West. It also raises the risk of a shift towards US isolationism, which would have significant consequences for economic and national security in US-aligned countries. Most of all, it means **the global policymaking environment will become more uncertain**. Shocks will become more common. The macro and market consequences of these will not necessarily show up in measures such as GDP. Moreover, they will differ from country to country.

Key issues for major economies and the likely implications for major asset classes

The potential blow to China

Large US tariffs would hurt China's export sector, but less than many suppose. Exports of goods to the US drive **less than 3% of China's GDP**. Allow for an offset from the exchange rate, some tariff evasion and redirection of China's manufacturing output to other markets, and the willingness of US consumers to pay higher prices, and the cumulative impact of even a 60% US tariff on all goods from China would be **well under 1% of its GDP**. The impact would be magnified if US tariffs triggered a broad global retreat behind protectionist walls. But we think that other major trading economies and China itself are likely to want to preserve many of the benefits of relatively open trade. Indeed, a pivot to tariffs and isolationism by the US that antagonised traditional allies might provide a way in for China to undermine the Western controls on strategically-important technology that are holding back Chinese industry.

Nowhere is the range of possible trajectories under Trump wider than in US policy towards Taiwan. Some of those close to him are hawks who argue that the US should commit itself to Taiwan's defence. But **Trump might also be open to a deal with China**. Between those two possibilities lies wide scope for misunderstanding that could result in a military and global economic crisis.

The consequences for Europe

The second Trump presidency would probably lead to **slightly weaker economic growth in Europe** but the magnitude of any effects would be too small for us to change our forecasts. We estimate that if the euro depreciated by 10% that would push up inflation by around 0.4ppts; this could be offset by lower global goods price inflation and should be a one-off temporary increase rather than pushing up underlying price pressures.

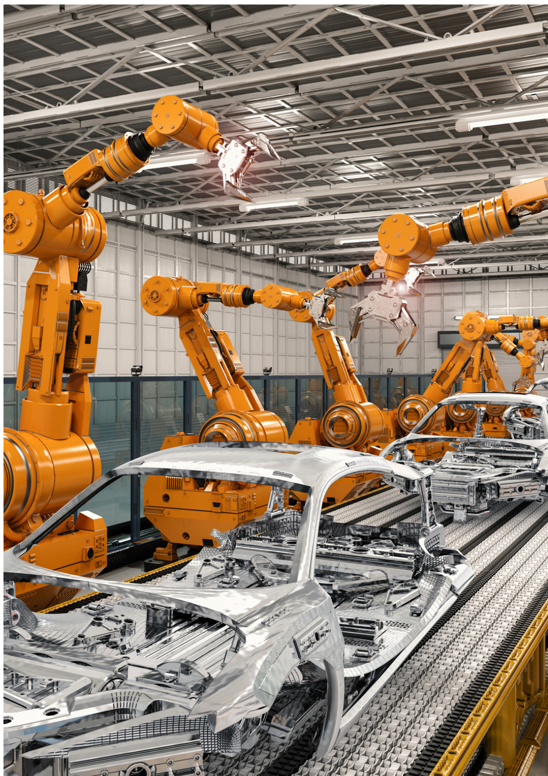
Overall, we do not anticipate changing our forecasts for the ECB, Bank of England or other European central banks for which the domestic inflation rate will be the key driver of policy decisions..

A second Trump presidency is likely to **accelerate the global fracturing** which we think is a headwind for Europe. However, we estimate that the direct impact of a 10% US tariff on all imports would be only **a fraction of a percent of GDP for the euro-zone**, though it would be bigger for Germany, which exports more goods than most to the US.

Clearly the consequences would be larger if the US implemented a 20% universal tariff, as Trump has also suggested. And a **100% tariff on European cars**, which could also come into play, would be a **major hit for Germany**, whose auto exports to the US were worth slightly more than 0.5% of GDP in 2023, though the impact on the European Union as a whole would be less than half that size. The impact of US tariffs on the UK would be much smaller than for Germany because it exports more services which we assume will be not be hit by tariffs - changes to our UK inflation forecasts are due to the UK Budget, not a result of the US Election.

The EU would be likely to retaliate with tariffs of its own.

But our working assumption is that they would be on the US only rather than universal and would be smaller, and perhaps more targeted, than the US tariffs on Europe. European policymakers would aim to limit the risk of a bigger lurch towards protectionism and to preserve what remains of the global rules-based trading system. The EU would also be open to trade negotiations before any US tariffs were introduced. European trade with China may also be affected though the EU would not necessarily comply with US pressure to match its own tariff policy towards China.



Effects on EMs and conflict in Ukraine and the Middle East

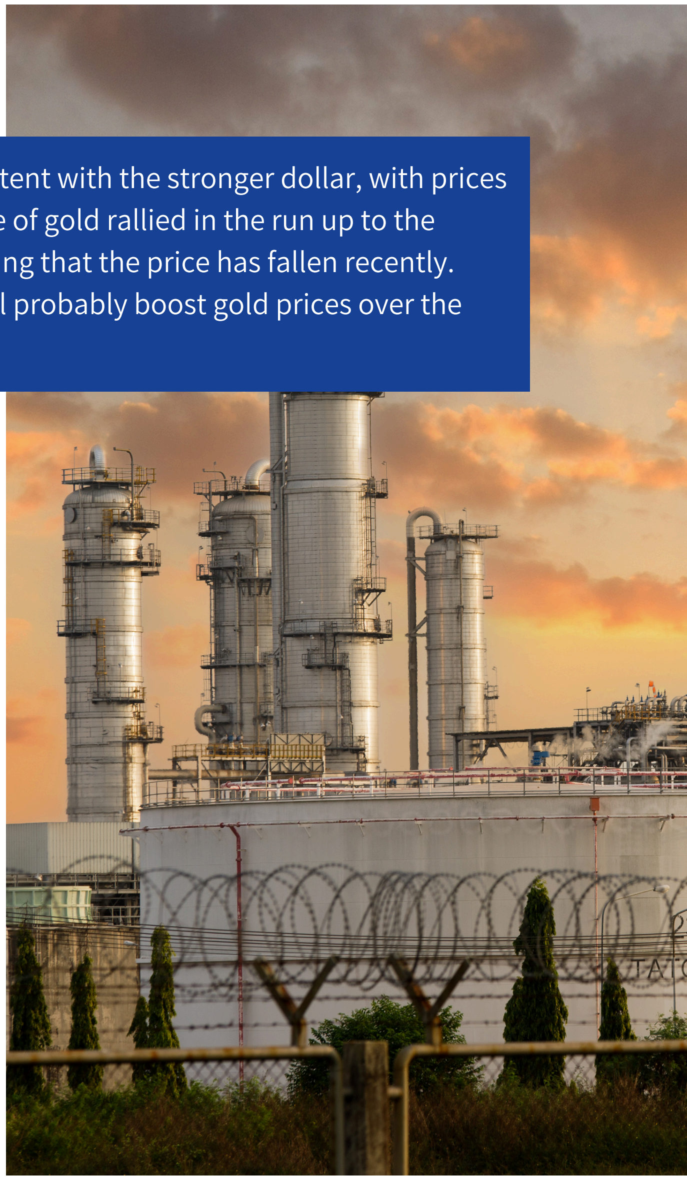
Donald Trump's commitment to end the Russia-Ukraine war suggests that the US will rapidly scale back military support and put pressure on Kiev to reach a deal with Russia even if that means de facto ceding some territory. The EU and UK would not be able or willing to fully substitute for US support. As we noted here, an **end to the Russia-Ukraine conflict would have limited economic consequences** for Europe because **energy prices would not fall** far and Europe would not resume large-scale energy imports from Russia. Nor would there be a fiscal "peace dividend" for European governments as they would be wary of further Russian expansion and would stick to the 2%-of-GDP defence spending commitment.

On the geopolitical front, as mentioned above, Trump has made ending the war in Ukraine a priority. A ceasefire might alleviate overheating in Russia's economy, but we don't expect a significant shift in Russia's energy trade or easing of sanctions. In the Middle East, Trump will probably stick to the pro-Israel/anti-Iran stance that characterised his first term. That poses an upside risk to oil prices and could prolong shipping disruptions in the Red Sea.

EM currencies have fallen post-election and weaker exchange rates will act as a safety valve for EM exporters facing US import tariffs. But there will still be a near-term impact on export demand:

- Mexico is most vulnerable given the extent of supply chain integration with the US.
- If China is targeted with punitive tariffs, manufacturing-oriented EMs such as Vietnam and Mexico could still benefit in the longer term from investment by Western firms moving production out of China.
- Some EM central banks that follow the Fed closely – notably Indonesia and Mexico – and/or that are contending with above-target inflation (Central Europe and other parts of Latin America) will cut interest rates by less than we previously thought.
- Most Asian central banks' easing cycles probably won't be affected significantly.

Commodity market impact



The initial reaction in commodity markets has been consistent with the stronger dollar, with prices generally down 1-4% across the board. Given that the price of gold rallied in the run up to the election as part of the “Trump Trade”, it is perhaps surprising that the price has fallen recently. That said, more stagflationary conditions under Trump will probably boost gold prices over the coming years.

In terms of fossil fuel supply, Trump will clearly be supportive of domestic oil and gas production, which climbed to record levels under President Biden, and is also very likely to undo Biden’s pause on new LNG export approvals. Meanwhile, although Trump might exert greater pressure on the likes of Iran and Venezuela – which all else equal could reduce global oil supply and put upward pressure on prices – OPEC+ has significant spare capacity to make up for this if it chose to do so. In terms of oil demand, we had previously been confident that Trump would try to remove subsidies for electric vehicles or weaken vehicle emission standards – which would have reduced the scale of gasoline displacement. That said, his increasingly close ties with Elon Musk might cause him to tread more lightly. Finally, to the extent that tariffs are a headwind for economic activity in China, this would also be negative for industrial metals prices at the margin. On net, we suspect that the impact on global oil prices will be negligible and demand from China and supply from OPEC+ are much bigger drivers than US policy.

On the climate front, the return of Trump will overshadow COP29 in Baku which starts next week. His presidency will be a symbolic shot across the bows for global efforts to reduce emissions – particularly as he will almost certainly withdraw the US from the Paris Agreement again. But as we have argued before, for all of Trump’s rhetoric and threats to take a hatchet to the subsidies and tax credits in the Inflation Reduction Act, he has every incentive to be heavy in words but lighter in action.

The Trump trade and how it could evolve

The reaction in financial markets has been broadly as expected given the election outcome: the **"Trump Trade" is in full swing**, with Treasury yields rising, the US dollar rallying and US equity futures, especially those linked to banks and small-cap indices, surging while most major equity indices elsewhere are flat or down (in dollar terms). This is similar to the aftermath of the 2016 election; with this in mind, we expect these trends to continue over the coming days before settling down, especially if Republican control of the House is confirmed.

Further out, the impact on markets will, plainly, depend on **how much of his campaign rhetoric translates into policy**. We think that the **10-year Treasury yield** will now remain around **4.5%**, and the **DXY index will appreciate by 3-5%** rather than weaken; the risks are skewed towards larger rises, in both cases. Economies such as China and Mexico that appear to be first in the firing line for US tariffs may see a larger negative impact.

> **We remain very optimistic about the outlook for US equities, but may revise down our forecasts for equities in other major economies.**

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