Perspectives

Flash Comment

SwissLife Asset Managers

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US elections: impact and prospects

What has happened?

- Donald Trump won a surprisingly strong mandate in the 5 November election. The Republicans also gained a majority in the Senate and stand a good chance, at the time of writing, to maintain their majority in the House of Representatives.
- On 6 November, markets reacted as expected. US equity markets and in particular small caps and value stocks shot up. US Treasury bond yields increased significantly, and USD credit spreads tightened modestly. European equity markets turned negative after a good start, reflecting the increasing economic risks. Meanwhile, European government bond yields fell only a little, and credit spreads tightened less than those in USD or even widened for High Yield. Finally, the USD appreciated against most major currencies.

Our economic assessment

- In the case of a Republican majority in both the House and the Senate, **fiscal policy** is set to become even looser. The appetite to curb spending is low, the "Trump tax cuts" from his first term will be extended and corporate taxes will be lowered.
- President Trump has no incentive to choke off the economy: (1) We thus expect targeted rather than significant across-the-board **tariffs**, with negative growth effects for China and Europe. (2) The **immigration** stance will firm, but the announced "mass deportation" of undocumented immigrants will likely hit legal, organisational, financial and political stumbling blocks.
- Tariffs, like tax increases, lead to a one-time shift in relative prices and should therefore be ignored by **monetary policy**. The Fed would only react to higher tariffs if they led to sustainably higher inflation expectations. While the Fed might again receive occasional criticism from the White House, there is no political incentive to actually push the Fed to an inflationary low-rate policy or install a "loose cannon" as a successor to Chair Powell. Inflation has proven to be unpopular, after all.

Our market assessment

- Financial markets are currently pricing a Republican majority in the Congress. This is very supportive for US companies' earnings growth but will also push government debt significantly higher, the consequence of lower (corporate) taxes and reduced regulation paired with significant increases in public spending. The confirmation of a Republican "sweep" might support US equity markets and credit spreads a bit further, while bond yields could move a little higher. On the other hand, a Democratic majority in the House of Representatives would lead to a partial reverse of the moves seen on 6 November.
- After the initial commotion, the markets' focus should return to economic fundamentals. US yields should therefore resume their fall and riskier assets are likely going to be repriced, although the change in the political context might delay these adjustments.
- The outlook is far less rosy for the rest of the world, although it boils down to how the Trump administration will use trade tariffs. While tariffs are likely to depress the global economy, Europe and the emerging economies would suffer more than the US. This implies an underperformance of their equity and credit markets relative to the those in the US. In this scenario, government bond yields are likely to fall because of lower growth and the accelerated move towards a supportive monetary policy by the central banks, although inflationary risks and the impact of a fast-increasing public debt will push in the opposite direction.
- China is in a unique situation. The risk of higher tariffs and the structural issues are a very negative combination. However, the positive reaction of its equity market to the US election suggests that many investors expect aggressive stimulus from the government. While we expect stimulus measures to be introduced gradually, the net effect from a Trump presidency on the economy and the markets in China is still likely to be negative.

Swiss Life Asset Managers

José Antonio Blanco
CIO Third Party Asset Management
Head Multi Asset
joseantonio.blanco@swisslife-am.com

Damian Künzi
Head Macroeconomic Research
damian.kuenzi@swisslife-am.com
@kunzi_damian

If you have any questions or if you would like to subscribe to this publication,
please send an email to: info@swisslife-am.com.
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