NZIER INSIGHT

65/2016

# Trumponomics

## Risks to the New Zealand economy

### It couldn't happen ... could it?

It looks more likely that Donald Trump could be elected as President of the United States (POTUS). Predictions now give Trump a 20-30% chance of victory, though these numbers are changing daily and who knows what scandals might surface between now and polling day on 8 November. We are also wary that most commentators didn't give Brexit a great chance of occurring, but were proven wrong.

### But what if it did?

Obviously a world with Donald as Commander in Chief would be different in so many ways to what we have seen recently – that, after all, is his rationale.

But we put his possible effect on world politics and stability to one side, and focus here on the hip pocket issues. We can think of the potential economic impacts of a Trump victory on the New Zealand economy along three timelines:

1. Short term financial market volatility
2. Medium term economic outlook
3. Longer term global trade challenges.

We explore each below.[1] A brief overview of Trump's economic policy platform is in the table on page 4.

### Expect short term financial market instability

Financial markets generally don't like uncertainty. If Trump were to be elected POTUS, it's difficult to see this being anything but a "bigly" headache for markets. Moreover, the way he has managed his campaign and the people associated with it suggests there might be a degree of chaos about the process of selecting and confirming key players in a Trump administration.[2]

The immediate impacts will likely be seen in credit conditions, the exchange rate and the US sharemarket.

If US and international financial markets perceive the economic and political outlook to be more worrisome under a Trump presidency, this has the potential to push up funding costs as increased risk aversion leads to a deterioration in access to credit. Given the international linkages of markets, this could flow through to New Zealand retail interest rates, making household and business **borrowing more expensive**.

As we saw with Brexit, currency markets could also get very jittery. Ordinarily, we might expect market concerns over the US economy's competitiveness to lead to a lower USD in the short term, as happened with the UK

[1] Effectively we are comparing potential outcome from a Trump-led government to those likely under a Hillary Clinton-as-POTUS scenario. A Clinton presidency would likely have far fewer negative impacts on New Zealand. Her stance on TPP is negative, but less so than her rival. It may be that with some clever tweaking and use of side-letters, the existing TPP framework could be rescued. The prospects for further regional economic integration would be more encouraging, or at least less problematic. Certainly, we would see a lot less alarmist rhetoric than we would under Trump; she understands the importance of diplomacy.

Clinton's economic policies would largely see a continuation of the status quo, albeit with a greater focus on the redistribution of wealth. While many economists – ourselves included – would argue with her specific policy prescriptions (lifting the minimum wage, higher taxes for the wealthy, higher estate and capital gains taxes, etc.), none are likely to be earth-shattering. If Clinton is POTUS, we would expect the US economy to largely continue on its existing path, and with it, the demand for New Zealand's exports.

[2] There are more than 4,000 political appointees in the federal government including all Cabinet level posts.

pound. However, the status of the USD as a preferred 'safe haven' asset in times of uncertainty might see this depreciation effect cancelled out, as investors shy away from more peripheral currencies such as the NZD. The net impact of these effects is difficult to gauge, but it's likely to be a **bumpy ride for currency markets**.[3]

We expect that the US sharemarket has largely priced in a Clinton victory. If Trump beats the odds and wins we would expect to see a large drop in equity markets reflecting concerns about the negative impact Trump's economic policies will have on businesses and the US economy more generally. These concerns could be mitigated to some extent by reassurances from the Federal Reserve that it would step in to provide support to the US economy if required. At the very least we are likely to see the **central bank hold off lifting its policy rate** this year given the increased uncertainty over the US economic growth outlook.

In combination, these three effects all point towards market volatility. New Zealand firms will need to prepare for this and either take appropriate hedging cover or hold firm like Trump's comb-over and ride it through.

## Softer US economic growth will reduce the demand for New Zealand's exports

The US is a crucial market for many New Zealand firms. We **exported $8.4 billion of goods and services** there in CY2015, accounting for 12% of our total export revenue. Key products are beef ($1.6 billion), dairy ($1 billion), wine ($432 million), lamb ($288 million) and wood ($182 million), plus tourism (over 240,000 visitors).

Despite Trump's assurances about how "great" or "terrific" the economy will be under his watch, his policy prescriptions don't warrant a great deal of optimism in our view. Certainly, there has been no reputable economic assessment that shows just how his bright ideas will generate sustained productivity and living standards growth.

One estimate[4] is that Trump's trade policies alone – namely imposing 35-45% tariffs on Mexican and Chinese imports – could result in the **loss of up to 4.8 million US jobs**. Ouch.

If Trump's economic policies result in a slower-growing US economy, either directly through poorly designed interventions, or indirectly via a loss in investment or hiring intentions from nervous firms (again, à la Brexit), we would **expect the demand for New Zealand's exports to drop**.

Precisely how much is hard to estimate, given the enormous uncertainty over the real economic impacts of his policy platform and the likely path of the exchange rate, but a weaker US economy is not great news for Kiwi firms. A weaker US economy will also have **negative implications for the global economy**, so New Zealand exporters could experience a double-whammy.

## The slippery slope: a retreat to protectionism?

From a New Zealand perspective, the most concerning aspects of Trump's proposed economic policies are his views on trade. He has run on a platform of **protectionist and mercantilist rhetoric**.

Most notable are his plans to introduce a 45% tariff on all imports from China and 35% on non-oil imports from Mexico. This plays well to his galleries, who equate imports with job losses, but could be economically disastrous – and not just for the US.

Imposing **such tariffs would make US households worse off**. The prices of imported consumer goods would rise sharply, reducing households' purchasing power. That is, their incomes will be able to buy fewer goods and services than before the tariffs were imposed. One think-tank has calculated that Trump's trade policies would increase a family's 'back to school' expenses by US$300, for example.[5] And we know that poorer families tend to

3 ASB notes that the medium term impacts of Trump's economic policies are likely to be inflationary, which will push up the USD. See https://reports.asb.co.nz/tp/download/641575/136f586783fc0c7b7bc64ddc63998c8c/QF16-Oct.pdf

4 Peterson Institute for International Economics. 2016. 'Assessing Trade Agendas in the US Presidential Campaign'. PIIE Briefing, September 2016. https://piie.com/system/files/documents/piieb16-6.pdf

Note that this is likely to be an over-estimate due to the 'multiplier' methodology used, which doesn't allow for resources to be reallocated across industries following a shock to the economy. But if the job losses are even half or a quarter of this estimate, that's not to be sniffed at.

5 See http://www.thirdway.org/memo/trade-blues-how-trump-hurts-your-back-to-school-shopping-list. We would expect that over time, the US would source some of these imports from other producers instead of China and Mexico, but this substitution is unlikely to happen immediately or completely.

spend more on imports as a proportion of their incomes than richer families, so these tariffs would have a **disproportionately damaging impact on the working class** whom Trump claims to represent.

Well, you could wonder, that may be true, but won't this result in more domestic production and therefore job creation, with associated income gains? Possibly, but unlikely. As noted above, Trump's policies are expected to lead to job losses as resources are directed to otherwise inefficient industries hiding behind huge tariff walls, and household spending power drops. If US manufacturing is to remain internationally competitive, the shift needs to be towards more capital-intensive production processes, rather than labour-intensive ones.

In addition, it's unlikely that China and Mexico would just sit there and accept these higher tariffs without retaliation. A natural response would be to impose tariffs on their imports from the US. That will **harm US export competitiveness**, creating another economic headwind.

If isolationism was the recipe for economic success, then North Korea would be the poster-child.

## Deal or no deal? No deal, probably

Trump has labelled free trade agreements (FTAs) and regional integration initiatives such as the Trans-Pacific Partnership (TPP) and the North American Free Trade Agreement (NAFTA) as "horrible", "terrible" and "disastrous".

His objections aren't always clear or coherent,[6] but the consistent takeaway is that Trump would seek to rip up these agreements and re-negotiate them. By "re-negotiate", he appears to mean "secure more benefits for the US in exchange for giving lower benefits to everyone else". The concept that other parties to these agreements might not be overly keen to re-negotiate along these lines doesn't appear to be a concern. Still, he has a lot of property – the best property – so knows plenty about negotiations.

In a Trump-as-POTUS scenario, the **prospects for further regional economic integration in the Asia-Pacific region would be dimmed**. The TPP, at least in its current shape, would likely gather dust. Although other participants could potentially move to a TPP Mark II that left out the US, the potential economic gains to New Zealand would likely be lower (bigger FTAs generally deliver greater benefits).

Another vehicle for regional integration, the long-discussed Free Trade Area of the Asia-Pacific for APEC economies, would struggle to move ahead, not least because both the US and China are both APEC members.

Trump isn't very keen on the World Trade Organisation either, so multilateral efforts to further liberalise trade could be further hampered. Indeed, the **negative impacts of a Trump presidency on US and global institutions**, and on the prospects for US leadership in global affairs, are worrying.

## Strap in for a bumpy ride

**If** Trump were able to fulfil his campaign promises on trade and foreign policy,[7] he would be sending a clear message to the rest of the world: we plan to do whatever we please, and damn the consequences for the rest of you. This is a big **if** given the rift between Trump and the Republican party and risk that the Democratic Party may win control of the Senate. There is plenty of scope for debate about just how powerful Trump would actually be if he were to take the Oval Office, given the checks and balances provided by Constitution.

However, the sentiments expressed during the campaign and the uncertainty that would be created would be **deeply disturbing for a small economy like New Zealand**, which has historically been one of the big winners from a liberal global trade and economic integration environment.

[6] Trump devotees may think that "Chiiii-na" is part of one or both of those agreements, given how quickly he 'pivots' all trade-related discussions back to that's country's activities.

[7] Of course, it's easy to talk tough on the stump. The reality if Trump were to take the Oval Office, would be quite different. Taxation and fiscal policy are dominated by Congress. But at least in the area of trade policy, Peterson Institute for International Economics (2016) argues that there is "ample precedent and scope for a US president to unilaterally raise tariffs as Trump has vowed to do as a centerpiece of his trade policy. Any effort to block Trump's actions through the courts, or amend the authorizing statutes in Congress, would be difficult and time-consuming".

## Implications of Trump's key economic policy positions

| Economic policy | Likely impact | Economic significance |
|---|---|---|
| **Reform the tax code:** Cut taxes at all income levels, especially at the 80th income percentile. | Will improve incentives to work, save and invest. But will also decrease government's tax revenue by US$4.4 trillion over the next decade. This could increase national debt by around 80% of GDP by 2036, which will impose additional debt servicing costs on future generations.[8] | Negative |
| **Immigration policy:** Send criminal aliens home. Welcome the useful migrants. | Increase in technical efficiency if more productive migrants replace less productive (illegal) migrants. However, such a strict (and potentially unreliable) migration policy may create disincentives for future immigration flows. | Neutral or negative |
| **Foreign policy:** Destroy radical Islamic terrorist groups. End the nuclear deal with Iran. | Sending more troops to 'destroy' ISIS will increase the cost of war remarkably (past experience: Iraq 2003). The higher cost of war is likely to dampen consumption in the US.<br>Leaving alone the penalties of ending the nuclear deal with Tehran, any change in the agreement will likely have a negative impact on America's reputation. | Negative |
| **Government spending and jobs policies:** Cut government costs and create more jobs. | Several Trump policies such as increasing salaries and improving national security will be associated with a *higher* government cost. Hence, a cut in the Federal budget does not sound realistic or will come at a large cost to other parts of the economy and an increase in American's debt. A bigger government is likely to be associated with a lower growth (as Trump says). | Negative |

**Source: NZIER**

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[8] Nunns, James R., Leonard E. Burman, Jeffrey Rohaly, Joseph Rosenberg. 2015. Analysis of Donald Trump's Tax Plan. Tax Policy Center.