

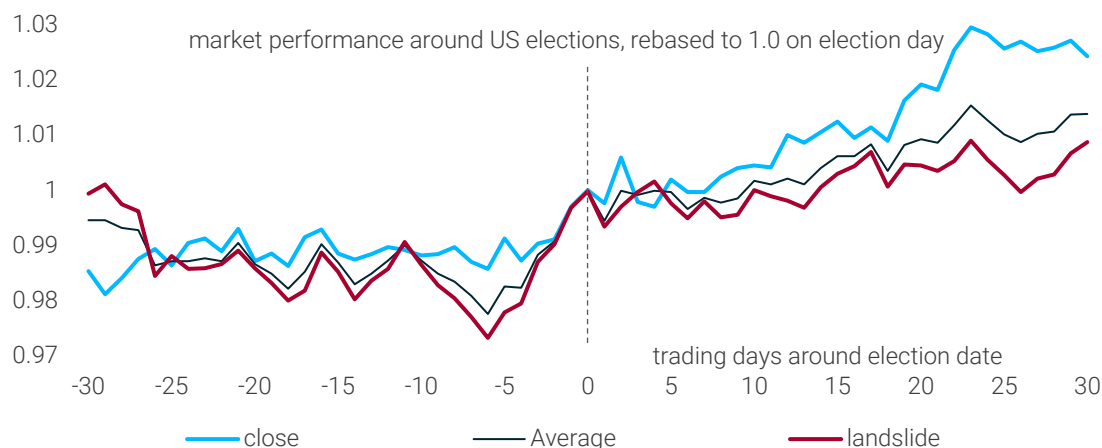
## Macro Picture

# TRUMP REFLATION TRADE TO FIZZLE OUT?

Dario Perkins

Mainstream macro doesn't like this US election, with its two candidates who want to spend "too much" and interfere with markets in various ways (tariffs, industrial policies, price controls and threats to Fed independence). The angst is probably overdone, but the political consensus has clearly shifted against the neoliberal supercycle of the past half century.

**Chart 1: Just make it stop! Close elections usually greeted with a relief rally**



Source: [Study by Rob Arnott Forest Henslee](#)

## FISCAL FISTICUFFS

A lot of market commentary is focused on the fiscal repercussions of the US election, with both candidates promising to rack up trillions of dollars of additional debt. These worries are overblown, both in terms of the inflationary consequences and the danger of a fiscal crisis. A "Liz Truss moment" is unlikely in the US, regardless of who emerges as the election winner.

## THE INTERVENTIONISTS

While risk assets would cheer a Trump Presidency in the short term (corporate tax cuts will directly boost earnings), his obsession with tariffs could eventually prove problematic. It is harder to assess any threat to Fed independence or the dollar's reserve status, but we lean against worst-case scenarios. And we see no prospect of price controls etc. under a President Harris.

## THE PENDULUM SWINGS

The interesting thing about this election is that – to varying degrees – both candidates reject the post-1980s neoliberal consensus. Regardless of who wins, we have entered an era of larger fiscal deficits, greater government intervention, more strategic industrial policy and more protectionism. But that doesn't mean we are headed back to the nasty stagflation of the 1970s.

## TRUMP REFLATION TRADE TO FIZZLE OUT?

The US election season has reached fever pitch, with a lot of excitable punditry about what this vote mean for the economy – and financial markets – over the next four years. Mainstream macro is worried, particularly about the fiscal trajectory. Both candidates are promising to add trillions of dollars to the public debt over the next decade; and even if this budgetary largesse fails to trigger a debt crisis, it could reignite inflation. We think anxiety about the US fiscal situation is overdone. The more aggressive budgetary easing would come from a second Trump term; but – much like during his first term – the proposed stimulus would take the form of regressive tax cuts, which probably would not move the dial on employment or inflation (the “fiscal multipliers” on Trump’s plan are modest). Although Harris’s proposals could deliver more “bang for the buck”, they are on a much more conservative scale. Regardless of who wins the election, we see no real prospect of a “Liz Truss moment” in the US: not only is there no magic threshold or “tipping point” for debt sustainability; there is no direct link government issuance and bond yields, contrary to the popular narrative (again) among pundits in the financial press. As long as US bonds retain their basic safe-haven properties, we are not facing a sudden blowout in the term premium.

Of course, it isn’t just the fiscal outlook that is worrying the macro community. Regardless of who wins the election, we are looking at a more “interventionist” US administration. Under Trump, this would likely take the form of a significant ratcheting up in the trade war, although he has threatened to engineer a big devaluation in USD and, not least, has made a thinly veiled attack on the Fed’s independence. Alternatively, under a Harris Presidency, there would be a continuation of President Biden’s strategic industrial policies, alongside a potential war on “price gouging” (there has even been talk of direct price controls). Again, we would caution investors not to jump to worst-case scenarios. Trump’s tariffs are the most immediate threat to the global economy, although their impact will ultimately depend on the scale and breadth of the duties levied. Even if Trump’s aggressive rhetoric in this area is merely a negotiating strategy (perhaps towards a 1980s-style trade resolution, as his proponents claim), he likes to weaponize uncertainty, which has the potential to unsettle markets and cap valuations. For investors who are worried about risk premia (including the term premium), tariffs are a bigger threat than “too much debt issuance”.

For all the election angst we hear from global investors, the immediate market reaction is sure to be conditioned by the prospect of corporate tax cuts, with a Trump victory certain to generate the more enthusiastic response. That would repeat the pattern of previous US elections, where the transition from a Democratic to a Republican administration has usually triggered a stock market rally. The big question, of course, is whether a bullish response (and the “reflation trade” more generally), would quickly fizzle out, which is what typically happened in the past. Given the prospect of tariffs, this has to be a realistic scenario. But we are more interested in what the vote tells us about the longer-term direction of the economy, particularly as both candidates – to varying degrees – reject post-1980s neoliberalism. Regardless of who wins, we have entered an era of larger deficits, more interventionist governments, greater protectionism and a lot more emphasis on rebuilding manufacturing and restoring worker power. Back in 2019, we drew the comparison between the pre-COVID economy and the late 1800s, when the political consensus shifted in such a way as to unleash a new macro supercycle. Win or lose, Trump has clearly set the parameters of this election; and his eulogizing of William McKinley is a reminder that there are deeper, structural forces at work in US politics. Some say this is a route to 70s-style stagflation. We are more optimistic: the US economy is in a fundamentally sound position and half a century of neoliberalism cannot be reversed in an instant. Even if the macro supercycle has reached an inflection point, it is turning only gradually. The US looks resilient – fade the doomsters.

# 1. FISCAL FISTICUFFS

We are not big fans of elections (or, for that matter, of politicians in general). And this latest US election has been particularly polarizing, which has made it hard to provide an objective take on the outlook without somebody taking offence. For at least the past six months, “politics” has been influencing perceptions about the current state of the US economy, not to mention opinions on what might happen after 2025. But with less than a week to go, it is important to think about what this election means for financial markets and the US economy, particularly as our exchanges with global investors have revealed a considerable amount of angst about what might happen. As always, we will focus on the questions that are top of the mind for our clients, such as whether the US “can afford” trillions of dollars of extra public debt (under either candidate) and whether a Trump Presidency 2.0 (“Trump Unchecked”) would mean tariffs of “2000%” on imported products. And we will try to map out the short-term implications of the various election scenarios, while putting our analysis into a broader historical context. But here’s an important disclaimer: we are based in the UK, so we do not have a horse in this particular race.

**Table 1: The main election proposals**

	Trump agenda	Harris agenda
<b>Taxes</b>	Extend expiring tax provisions Further cuts in corporate taxes	Only partial, progressive extension Expand child tax credit
<b>Defence</b>	Focus on national security and containing China Uncertainty over NATO funding and Ukraine war	Emphasis on global alliances and multilateralism Keep supporting Ukraine
<b>Energy</b>	"Drill baby drill" Rollback some of the IRA	"All of the above" – support for both renewables and fossil fuel
<b>Housing</b>	Tax incentives & subsidies for first-time buyers	Build 3 million new homes Support first-time buyers
<b>Immigration</b>	Stricter controls on unauthorized migrants Mass deportations (1.3 - 8.3 million)	More restrictions on unauthorized entry More preventative funding
<b>Regulation</b>	Deregulation of energy and banks More anti-trust for big tech	Greater oversight of energy, tech & finance Measures to prevent "price gouging"

Source: TS Lombard

## Trillions and trillions

The one thing we know about this US election is that neither candidate has any desire to restore “fiscal prudence”. Quite the opposite: both Trump and Harris have announced plans that involve high levels of borrowing in the years ahead. Not is the starting point deal. According to the IMF’s new Fiscal Monitor, the US fiscal deficit will average 7.6% of GDP in 2024, which is remarkably large for an economy operating at full employment (in the past there were US deficits of that magnitude only during really nasty recessions, after tax revenues had plunged and unemployment had soared). Given this backdrop, the anxiety we are hearing from investors is not surprising. Recent headlines in the financial press certainly have not helped. According to a

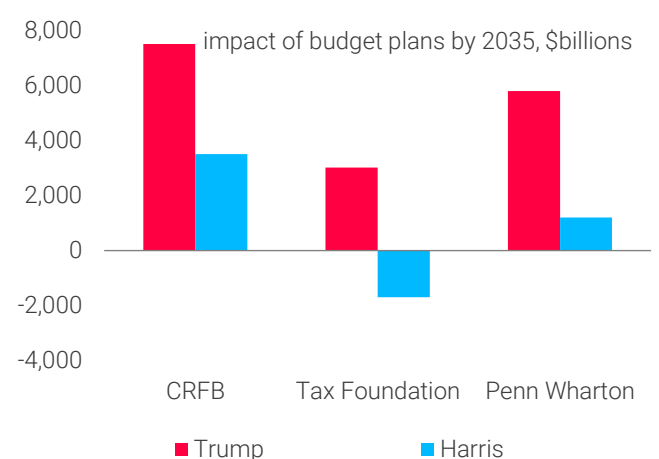
bombshell report from the (non-partisan) [Committee for a Responsible Federal Budget](#) (CRFB), the election will add either \$3.5 trillion or \$7.5 trillion to public debt by 2035, depending on which party wins. (And even that higher estimate – for Trump – could prove too optimistic: under gloomier assumptions, the CRFB warns that the election could add \$15 trillion in extra debt.)

**Chart 2: Trump reflation trade emerged in H2?**



Source: Datastream, TS Lombard

**Chart 3: Multi-trillion-dollar election**



Source: CRFB, Tax Foundation, Penn-Wharton, TS Lombard

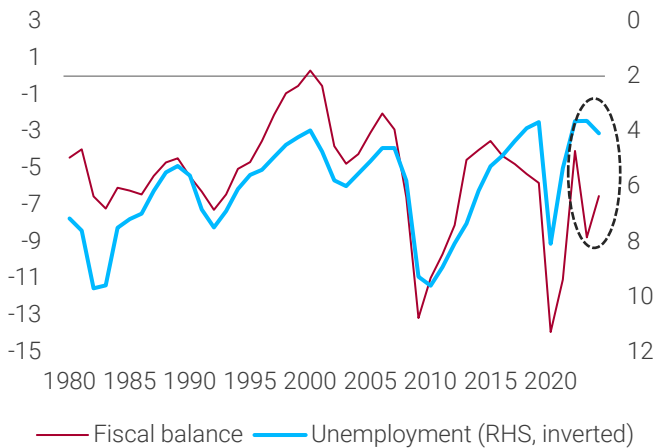
## Two fiscal risks

There are two types of investor anxiety about the post-election budget giveaway: (i) worries that the US is borrowing “too much”, which might trigger a Liz Truss-style “fiscal crisis”; and (ii) a weaker version of that risk, where there is no real budgetary “crisis” but the next president’s fiscal largesse generates a persistent inflation problem (unless the Fed intervenes, which would also be problematic). On the first of these worries, it is, of course, not the first time we have heard warnings about the dangers of fiscal delinquency in the US. A similar narrative was popular exactly 12 months ago, when a number of big-name hedge-fund managers appeared in the press to warn about the dangers of the “term premium”. Back then, the worry was that “too much issuance” (or “too much net supply”) would lead to a nasty reflexive doom loop, where deficits and higher yields would feed on each other, creating a dangerous spiral. We [pushed back on that narrative because we felt it was a mischaracterization of what drives the term premium](#). That position was justified by subsequent price action: term premia eased, even as issuance continued at high levels and the Fed pushed on with its QT programme (which removed duration).

## Crisis talk is overdone

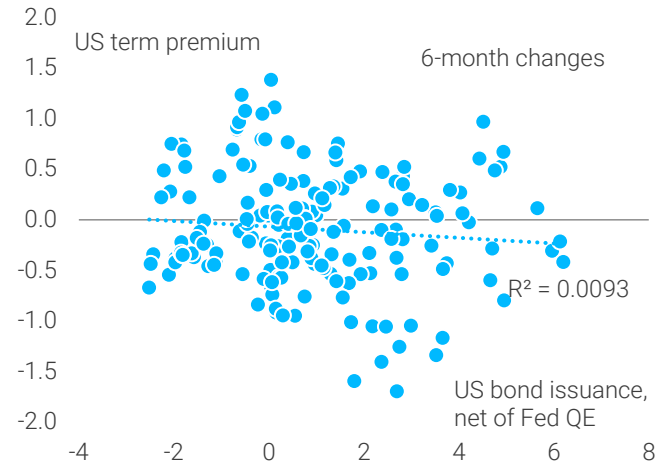
As was the case in autumn 2023, we think talk of a debt crisis in the US is overblown. First, the fiscal outlook is not nearly as dire as the headlines in the press suggest. When the likes of the CRFB speak in terms of “trillions of dollars of debt”, it is important to remember that these are *cumulative* numbers over a 10-year period. Not only are their estimates extremely uncertain, but they do not take into account the size of the economy or the global demand for US Treasuries as a “safe asset”. The ratio of debt to GDP is arguably the more relevant metric, but even that is difficult to forecast because it depends on assumptions about nominal GDP (which, these days, are too pessimistic) and it is not as if there is a magic threshold beyond which fiscal sustainability becomes a problem. Indeed, the [most comprehensive research](#) has dismissed the notion that such a threshold exists or that there is a level of debt beyond which government borrowing hurts GDP growth.

Chart 4: Big deficits at full employment



Source: IMF, OECD, TS lombard

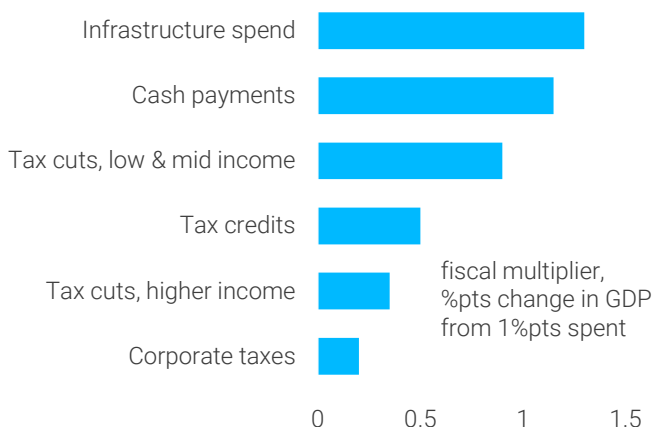
Chart 5: Issuance doesn't drive the term premium



Source: TS Lombard, Fed

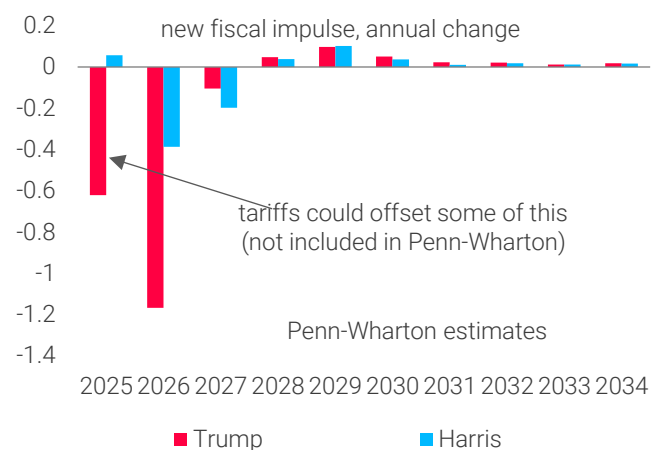
The second reason we are not overly worried about a US fiscal crisis is that, contrary to popular mythology, there is no discernible relationship between debt issuance and the term premium (see Chart 5). We think a lot of macro pundits misunderstand this. What drives the term premium is not the size of the deficit but rather the nature of the shocks that are hitting the economy. When demand shocks are dominant, as they have been since the 1990s, inflation is *procyclical* and this gives bonds a natural hedging property, which compresses the term premium (because investors, in effect, have to pay a fee to use those hedging properties in their portfolios). When supply shocks are dominant, inflation becomes counter-cyclical and bonds start to lose their hedging properties, which is what causes the term premium to widen. Looking at the 2020s, the big risk to bond yields is not that governments will be “spending too much” but rather that supply shocks become more prevalent. Our analysis suggests this will dilute the insurance properties of bonds, but not eliminate them altogether. Most of the time, US Treasuries will remain a “safe asset”, which means the term premium should widen but not “blow out” in a crisis-inducing manner.

Chart 6: US fiscal multipliers



Source: CBO

Chart 7: The fiscal impulse is front-loaded

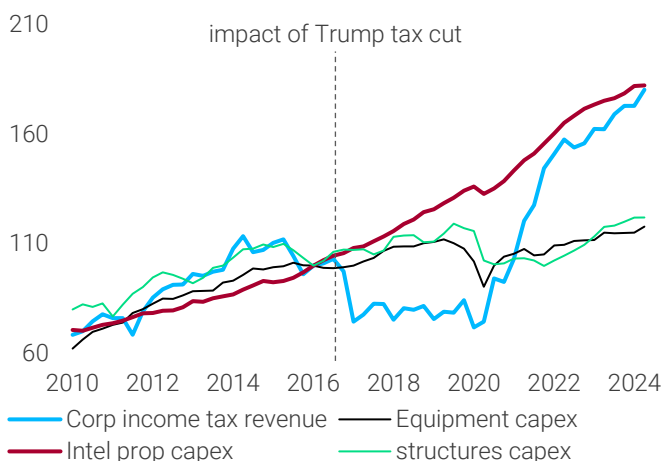


Source: Penn-Wharton, TS Lombard

## Fiscal inflation risk

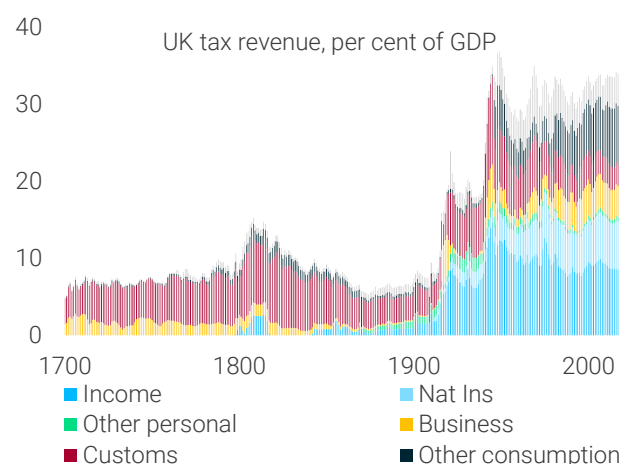
While we see no immediate prospect of a budgetary crisis in the US, the lesser evil of fiscally induced inflation cannot be ruled out. Comparing the plans of the two election candidates, Trump's would appear to pose the greater threat to inflation because they are by far the more aggressive. But the degree to which fiscal policy moves the dial on inflation also depends on the specific form it takes, not just the amount of new debt that is created. And given that Trump's proposed stimulus is focused mainly on tax cuts for corporations and wealthy individuals, we suspect that its inflationary consequences will be relatively muted. That was certainly the case with the first round of Trumponomics, in 2017-18, when it was hard to identify a discernible boost to capital spending, let alone to employment or underlying inflation. Chart 8 shows that Trump's tax cuts significantly boosted corporate profits (tax revenues plunged), but it is not clear they generated any genuine uplift to economic activity, which is why the original Trump "reflation trade" fizzled out not long after the 2016 election.

Chart 8: Trump 1.0 not very stimulative



Source: BEA, TS Lombard

Chart 9: Modern economies don't tax imports



Source: OBR, TS Lombard

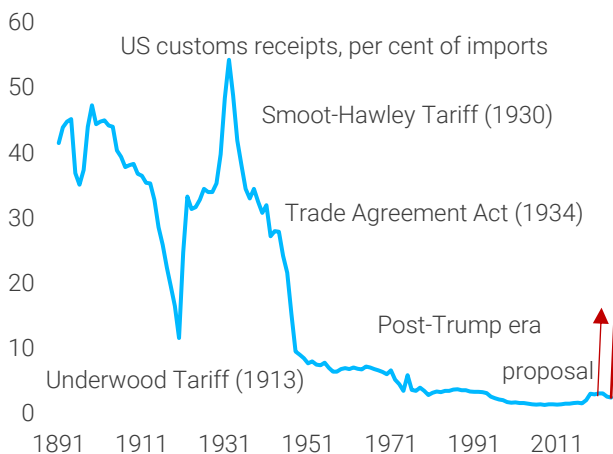
## Fiscal multipliers

The reason why tax cuts for corporations and wealthy individuals (or "regressive" fiscal policies, in general) do not move the dial on GDP and inflation is that they come with small "multipliers". The wealthy save a large proportion of any income gains, while companies typically base their capex decisions on *expected returns*, not free cashflow (tax cuts influence expected returns only indirectly, at best). In terms of "bang for the buck", the Harris proposals seem a lot more inflationary, at least per dollar spent. She is targeting stimulus at lower-income households (using, for example, the child tax credit), where fiscal multipliers are usually much higher. And she plans to continue with Biden's programme of incentivizing infrastructure investment and the creation of new manufacturing plants, which have big multipliers, too. But because the absolute magnitude of her proposals is modest, it is doubtful we will see a strong inflationary impact from a Harris victory either. As a general point, investors should remember that it is hard to create a persistent inflation problem using fiscal policy alone. What matters is not whether deficits stay large but whether they keep getting larger – i.e., it is the *impulse* from fiscal policy that matters. Chart 7 shows that the fiscal impulse from both candidates will fade quickly after the initial boost.

## 2. THE INTERVENTIONISTS

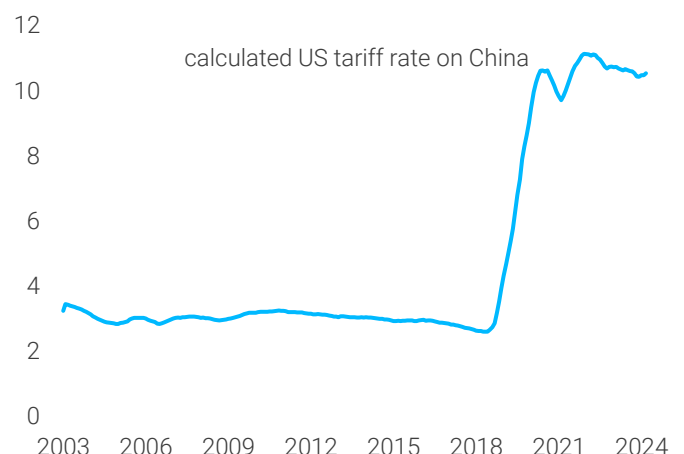
We think that mainstream anxiety about the US fiscal outlook is overdone. But is not just the candidates' tax and spend proposals that are causing a degree of angst among global investors; both Trump and Harris are also in favour of a more interventionist approach to macro policy, which could unsettle financial markets in other ways. With Trump, the big worry is obviously tariffs and the return of his trade wars. But he has also expressed support for mass deportations, a devaluation of the dollar and a dilution of the Fed's independence. With a Harris administration, we could be looking at interventionism through other channels, including strategic industrial policies and anti-price gouging measures (there has even been talk of price controls). Regardless of who wins the election, this is not the neoliberalism that financial markets are used to. And it is these more radical policy options – particularly the “weaponization of uncertainty” under a Trump administration – that are more likely to cause risk premia to widen in financial markets.

Chart 10: A radical trade proposition



Source: US customs, TS Lombard

Chart 11: Biden kept Trump's China tariffs



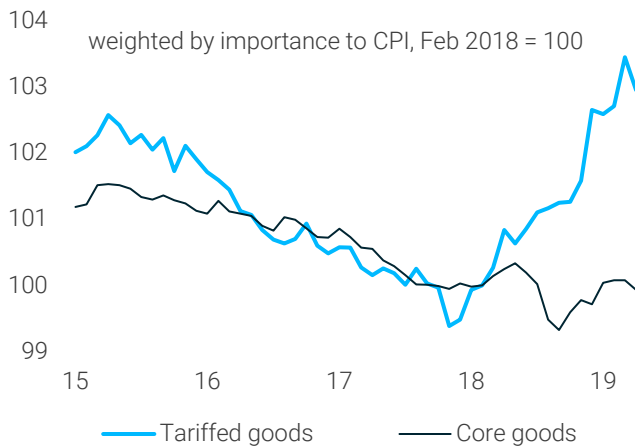
Source: US customs, TS Lombard

### Tariffs – the revenge

By now, everyone knows that Trump is a huge fan of tariffs (in fact, [his support for tariffs started in the 1980s](#), long before he had presidential ambitions). Not only were tariffs a hallmark of his first term in office, but he has taken every opportunity to talk up their virtues during the current election campaign. Back in July, during a lengthy interview with Bloomberg about economic policy, he described tariffs as “economically phenomenal”. More recently, talking to the Economic Club of Chicago, he said that “tariff” was “the most beautiful word in the dictionary”. Part of his support for this measure – as he explained to Bloomberg – is that he thinks tariffs are an important negotiating tool that can be used to threaten America's international competitors (and allies!). But he also believes something more fundamental: that the mainstream consensus is wrong about the negative consequences of these policies and that, ultimately, they are paid by America's competitors. He has even proposed [replacing income taxes with tariffs](#), which would be impossible because these account for a tiny fraction of a modern government's revenues.

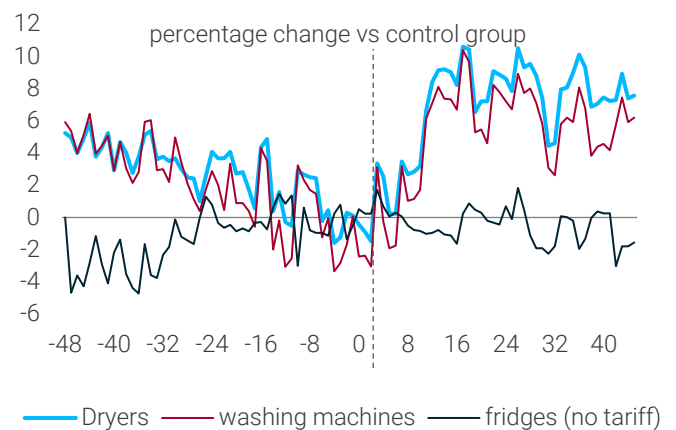


Chart 12: Tariffs raise consumer prices



Source: BLS, TS Lombard

Chart 13: The chart that started a Twitter war



Source: Aaron Flaaen et al (2020)

## The impact of tariffs

In principle, levying a tax on imports can have three effects:

- 1 Imported goods become more expensive (unless foreign companies offset that charge by reducing their prices and absorbing the difference in their margins). All else being equal, this improves the relative competitiveness of domestic producers.
- 2 Tariffs on intermediate goods (imported products that are then used to produce other goods and services) increase the costs of domestic producers, which damages profitability (unless they pass on those costs to their own consumers).
- 3 Retaliatory actions from other nations can be triggered, which will either hurt export volumes or force domestic exporters to accept a squeeze on their own margins.

That is the theory, but thanks to Trumponomics 1.0 – which has been studied extensively by economists across academia and central banking – we now have a [pretty sound empirical consensus of how tariffs also work in practice](#). The main conclusion of that analysis is that tariffs do raise consumer prices. That sounds obvious, but back in 2016 there was some uncertainty about the dynamic because, given the sheer size and competitiveness of the US market, there was a chance foreign producers would “price to market” and just accept smaller margins. Instead, careful analysis has shown (see [here](#), [here](#) and [here](#)) not only that tariffs raise consumer prices by the full amount of the import charge – none of it is paid by the foreign manufacturer – but they also have wider inflationary consequences, including both from complementary goods and from US producers taking advantage of reduced foreign competition to hike their own prices and expand their margins. (See this [study of the tariff on imported washing machines](#), which triggered a fierce argument between Justin Wolfers and the JD Vance camp.)

## The inflationary impulse

While we can be confident that new rounds of tariffs would raise consumer prices in the US, the magnitude of that effect would obviously depend on the *scale* of the tariff hikes and the *breadth* of the goods that they cover. Universal tariffs – applied to all imported products – would be a much bigger deal than individual charges levied on specific goods or countries (such as Chinese EVs). We can use [the following formula](#) as a rule of thumb:



Impact on CPI = change in effective tariff \* import share of goods \* goods share of the CPI

To put some numbers to that formula, we know that goods make up around 33% of the CPI and that imported products account for 26% of goods consumption. Now, let's assume that a second Trump administration would levy 60% tariffs on China and 10% tariffs on the rest of the world, which, amid all the usual rhetorical bluster, has been the Trump campaign's most concrete proposal. Since China accounts for 14% of US imports, that would raise the overall (trade-weighted or "effective") tariff rate to 17%, up from 2% currently (i.e., an increase of 15%pts). Plugging those numbers back into our rule of thumb, that would increase the CPI by around 1.3%pts:

Impact on CPI = 15% pts \* 0.26 \* 0.33 = 1.3% pts

There is no doubt these policy proposals would be both a big deal and a significant break from modern international standards. Chart 10 shows that an effective US tariff of 17% would be the highest rate since the late 1940s. And, of course, it is possible that Trump 2.0 would eventually go beyond those baseline tariffs. Trump talks about his 10% universal tariff as a *minimum* charge and has recently been threatening [tariffs of up to "2000%"](#) (which we assume is rhetoric, but it is always hard to separate what is a concrete plan from what is bluster or a negotiating strategy). But if our baseline estimates are correct, the direct inflationary consequences could be more muted than is commonly assumed, equivalent to a 20% increase in oil prices. While energy-price shocks of that magnitude are never helpful, they do not usually trigger an inflationary crash.

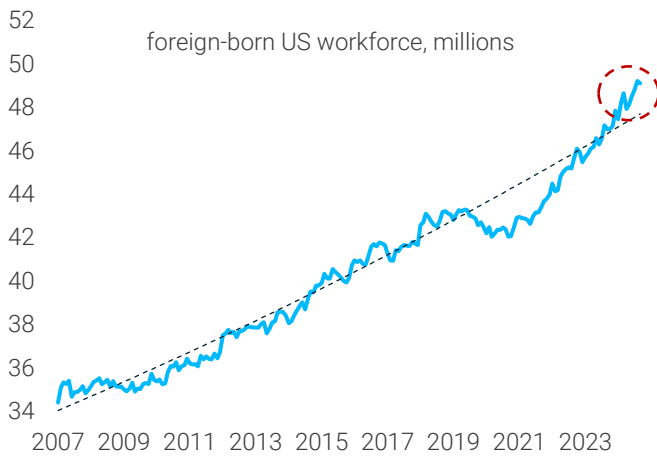
### How would the Fed respond?

Some investors are worried that the inflationary consequences of Trump's tariffs would set up a "fight" with the Fed, forcing the central bank to raise interest rates again. We see things rather differently, for two reasons. First, the price increases associated with tariffs are likely to be one-off, rather than the start of an inflationary spiral. [While they would raise the CPI, they would also hurt economic growth by squeezing real incomes and discouraging business investment.](#) People seem to have forgotten that the uncertainty associated with Trump's tariffs in 2017-18 damaged global manufacturing activity and capped the stock markets. For this reason, we think any reflationary impulse would be short-lived. Second, China's economy is in a much weaker position than it was during the first Trump administration. If China remains the main focus of Trump's aggressive policy, it is likely that Chinese officials would dampen some of the inflationary consequences of his tariffs by devaluing their exchange rate. As we explained in [a previous Macro Picture](#), we think China's structural weakness will provide a global deflationary draught.

### Negotiating tool?

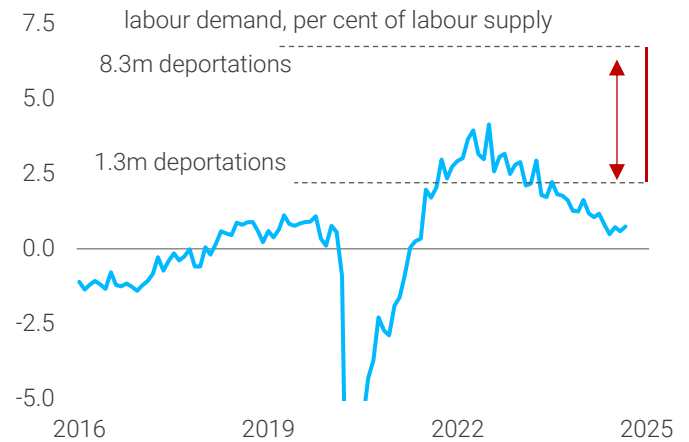
The optimistic take on Trump 2.0 is that all this talk about massive tariffs is just a negotiating ploy, designed to secure more favourable trade deals. Trump has spoken openly about allowing foreign companies to dodge his tariffs by setting up manufacturing facilities in the US. This sets up the possibility of a trade deal similar to the Reagan-Japan agreement of the 1980s. Back then, Japan agreed to voluntary export restrictions (i.e., quotas) on its auto industry and instead established manufacturing plants in the US. Over time, this curbed America's bilateral trade deficit and created jobs in the US ([although consumers had to pay higher prices](#)). It is possible this is the endgame again – an agreement that supports domestic US manufacturing and encourages "reshoring". The problem is that Japan was a geopolitical ally of the US in the 1980s, whereas today China is a geostrategic rival. And when it comes to modern automobiles, which are essentially computers on wheels, there are threats to US national security. We know Trump has a "transactional" approach to foreign policy; the question is to what extent that applies to China.

Chart 14: Immigration rebalanced the jobs market



Source: BLS, TS Lombard

Chart 15: Deportations would create new shortages

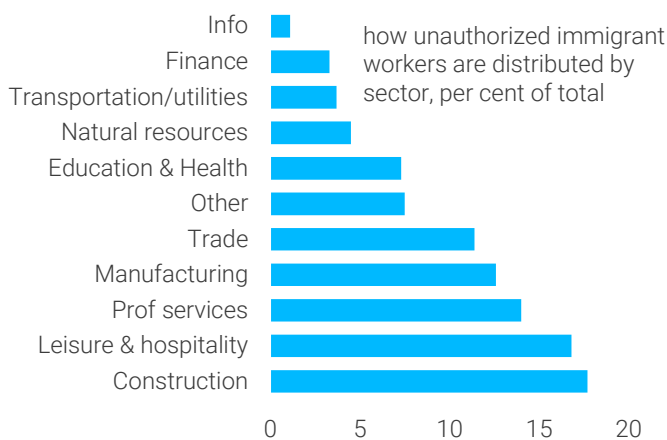


Source: BLS, TS Lombard

### More radical policies

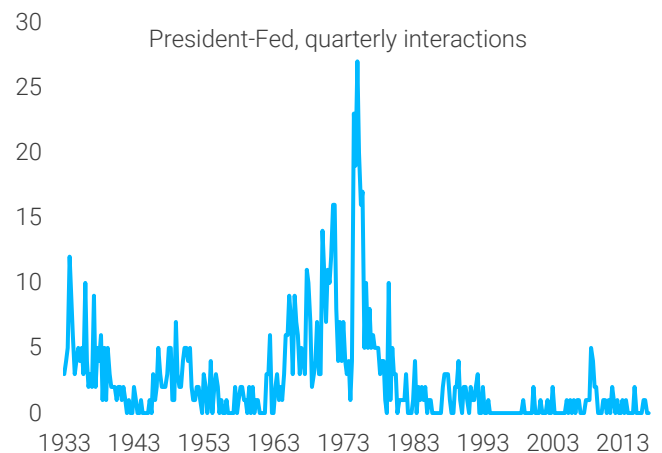
Large tariffs are analogous to a supply shock, because they cause prices to surge and growth to sink. This is a more serious threat to the term premium than anything that is happening on the fiscal side (the term premium hates countercyclical inflation). But as far as a persistent inflation problem is concerned, we worry more about other policies associated with Trump 2.0 – namely, his plan for mass deportations and his threats to the Fed's independence. Two years ago, the US labour market was extremely unbalanced with huge staff shortages across a range of sectors. Today, those imbalances have gone, largely because the US – like many other developed nations – saw a huge post-COVID surge in immigration (more than offsetting the original pandemic shortfall). Depending on their scale, mass deportations could recreate the severe labour shortages of two years ago, which is the one dynamic that might make the Fed want to start raising interest rates again (much more so than any tariff hike). Sectors like construction and hospitality would be hit especially hard (Charts 15 and 16).

Chart 16: Deportations will hit some sectors hard



Source: Wilmington Trust

Chart 17: Political interference with the Fed

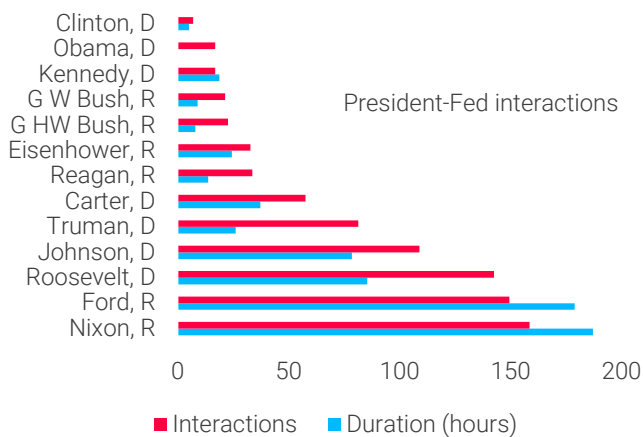


Source: Drechsel (2024)

## Fighting the Fed

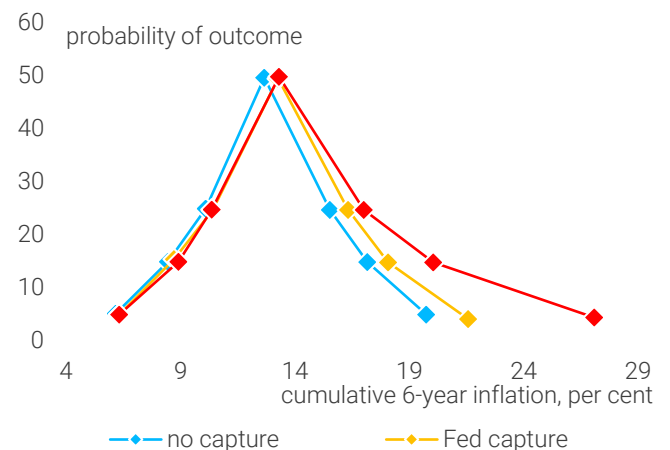
The question, of course, is whether Fed officials would get the opportunity to retighten monetary policy or whether the Trump administration would “lean” on the central bank to keep interest rates low. We know that during his first term, Trump tried to influence the Fed by regularly attacking Jay Powell on social media ([remember the Fed chair “who can’t putt”?](#)). This time, there are reports that Trump 2.0 could go even further, either by appointing “friendly” officials to the Fed, encouraging Powell to step down early (his term is not due to end until 2026) or by changing the central bank’s remit to allow greater “presidential oversight”. If so, this could have a major impact. Research has shown not only that [“political pressure shocks” have raised US inflation in the past](#) but that they could also [skew inflation risks higher in the future](#). The reality, of course, is that we have no real way to assess the seriousness of this threat. That said, given that Congress provides strong safeguards for Fed independence – and we do not yet know whether a Trump Presidency would even have full control over Congress – it is somewhat premature to worry about this risk.

Chart 18: Trump to pull a Nixon?



Source: Drechsel (2024)

Chart 19: Inflation skew from Fed capture



Source: The Budget Lab (2024)

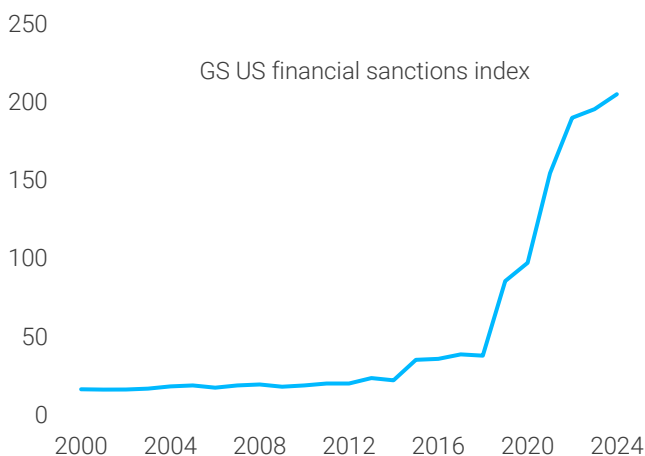
## A plan to trash the dollar?

Without undermining Fed independence, it is hard to see how a second Trump term could deliver a significant weakening in the dollar, which is another of his stated policy ambitions. Back in July, Trump described the strong dollar as “a big currency problem”, which he repeated twice – like many of his favourite mantras – to add emphasis. The issue, of course, is that the dollar is the world’s reserve currency and that, in itself, creates a structural bid for dollars – [because international companies want to borrow in USD and invoice their trade in that currency, even when there is no direct American counterpart in those trades or transactions](#). If Trump really wanted to weaken the currency, he would need to find ways to reduce the international appeal of the dollar. So far, this is happening only at the margins, as previous administrations’ weaponization of sanctions (Chart 21) has encouraged some foreign central banks to swap their dollars for gold. But for international capital markets and cross-border lending (particularly for corporates) there is no real USD alternative. (Note that tariffs have the opposite effect: they strengthen the dollar because they suppress imports and cause uncertainty.)

## The Harris proposals

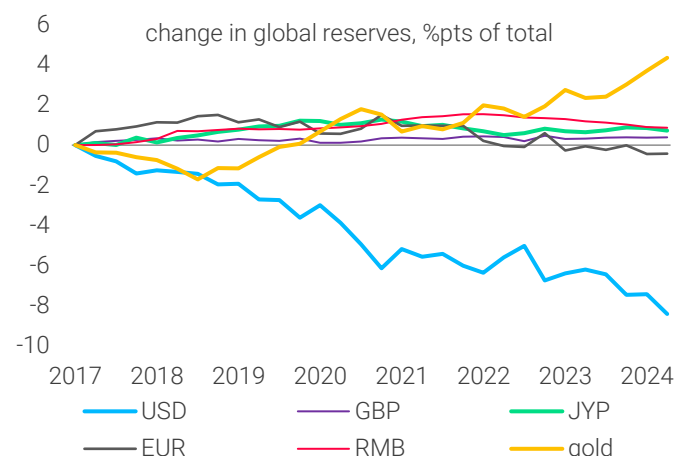
Given the strength of Trump's rhetoric, is it not surprising that many mainstream economists are worried about what the next four years will bring. But it is also clear that Trump has set the parameters of this election, and it is not as if his opponent is promising a return to the free-market *laissez faire* economics that typically finds favour among investors. Even if Harris is not going to impose 10%+ tariffs on her allies in Europe, China "de-risking" is here to stay, regardless of who wins the White House. And we should also expect a continuation of Biden's industrial policies, which are designed to accelerate the green transition and secure strategically important resources such as semiconductors. Though unpopular with many investors – who hate the idea of governments "picking winners" – these policies have been responsible for a massive increase in US manufacturing capacity. (And given that "red states" have been the main beneficiaries, these would probably continue under Trump, too). But there are some areas where Harris might be more "interventionist" than Biden, such as home building, support for social care and tackling "price gouging". Her views on corporate pricing power have been particularly controversial because she initially expressed some enthusiasm for the direct suppression of various prices.

Chart 20: Weaponizing the US dollar



Source: Goldman Sachs

Chart 21: Reserve status erosion?



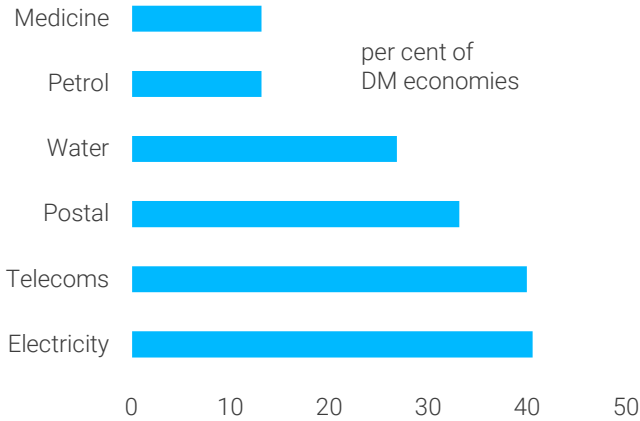
Source: IMF, TS Lombard

## Price controls?

While price controls still exist in many parts of the world (especially in certain industries), most economists have a natural aversion to them. To understand why, consider what happened in the early 1970s when the Nixon administration tried to suppress a secular acceleration in wages and prices through government legislation. [Analysis by Alan Blinder and William Newton](#) shows that price caps had only a temporary effect on inflation: they kept prices lower as long as they were in place (1971–74) but caused inflation to accelerate as soon as the government lifted them (1974–75). For the entire 1970s episode, Nixon's controls made no real difference to the amount of inflation the US experienced, altering only the timing of price hikes. We doubt price controls would be any more effective today, but this is a moot point because we cannot imagine a Harris Presidency – or any other US administration – trying them anytime soon. Harris has already

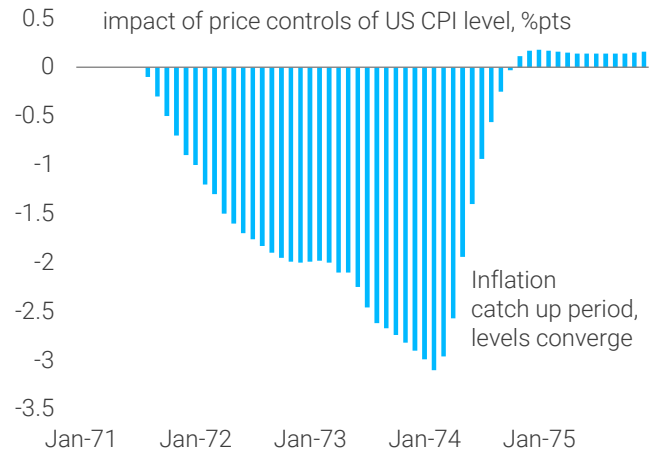
distanced herself from this idea (which tends to find more favour with [the likes of Elizabeth Warren](#)) and it now appears that these policies would be considered only in a COVID-like crisis.

Chart 22: Price controls still exist



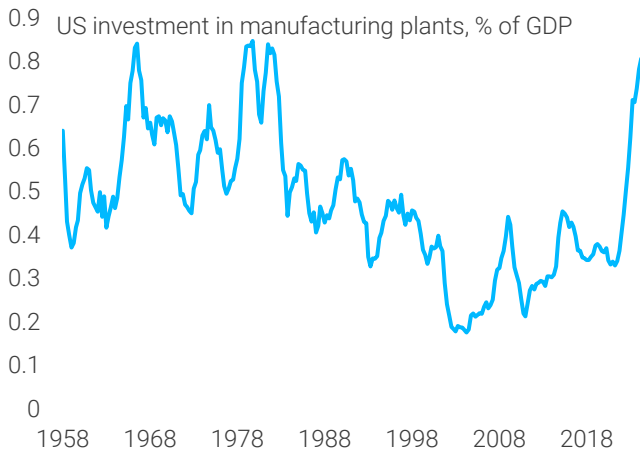
Source: IMF

Chart 23: Price controls didn't work in the 1970s



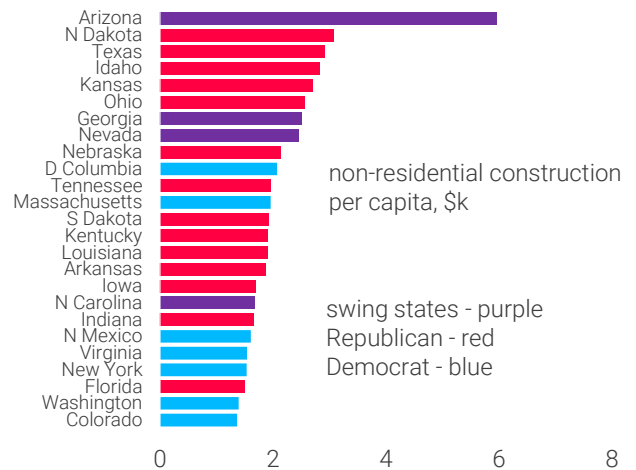
Source: Blinder study

Chart 24: Biden's manufacturing boom



Source: BEA, TS Lombard

Chart 25: Trump won't reverse Biden's IRA



Source: Joe Politano

### 3. THE PENDULUM SWINGS

Despite the concerns we hear from global investors, the US stock market seems to care only about one election issue: the prospect of corporate tax cuts following a Trump victory (presumably because these would have a direct effect on corporate earnings, whereas every other election issue is largely speculative). And US bonds have been selling off on the basis of the Trump "reflation trade". But this election remains too close to call, dependent on the marginal

votes of a few swing states, and we will see whether these market themes hold beyond 5 November (history suggests they won't, even if Trump wins). Beyond all the near-term uncertainties and potential market gyrations, we are more interested in what this election can tell us about the longer term. Perhaps there are deeper structural forces at work in US politics – forces that are shifting the basic trajectory of US growth and inflation. That was our view after Trump's election victory in 2016 and it remains our view today, irrespective of who emerges as the winner on 5 November.

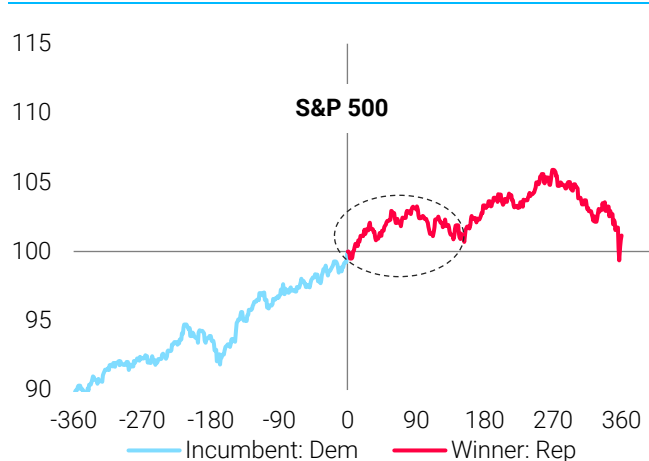
## Scenarios and market reaction

There are four scenarios for the election on 5 November:

- 1 Trump as president with a Republican clean sweep
- 2 Trump as president with a divided Congress
- 3 Harris as president with a Democratic clean sweep
- 4 Harris as president with a divided Congress

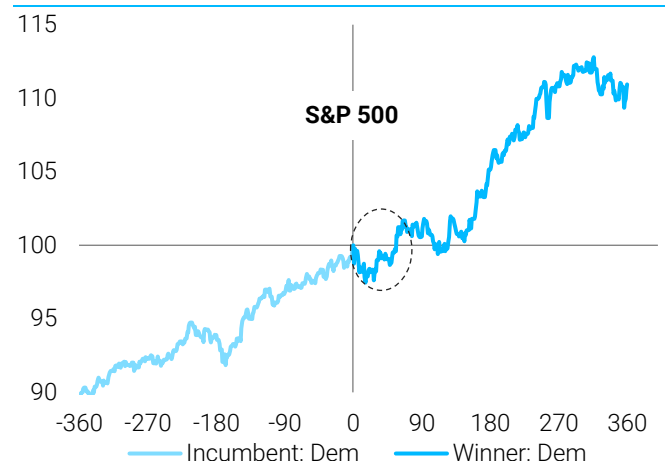
Given the stock market's obsession with corporate tax cuts, scenario (i) is likely to deliver the most bullish reaction in stock markets, at least initially. By the same logic, we should probably expect a short-term selloff in equities under scenario (iv), because a full mandate for Harris would see corporate taxes rise in 2026, when the current laws expire. The impact of scenarios (ii) and (iii) is more ambiguous but – assuming the election isn't contested – financial markets could still react favourably because a key source of uncertainty would be gone and there is evidence that stock markets always rise after a closely contested election is resolved, regardless of which party wins. Chart 1 (front page) is from [a recent study by Rob Arnott Forest Henslee](#), which makes an interesting point: "In slim-margin, divisive races... once the election is over and the uncertainty dissipates, those on the winning side will be relieved by the outcome and return to risk-on positions. Those on the losing side will no doubt be despondent, but they are already risk-off, so their portfolios already reflect those fears. Both sides sell in the weeks before the election. One side buys in its aftermath"... and... "stocks swing higher regardless of the winner's politics."

**Chart 26: Republican bounces don't usually last**



Source: Bloomberg, TS Lombard

**Chart 27: Democratic selloffs rapidly reverse, too**

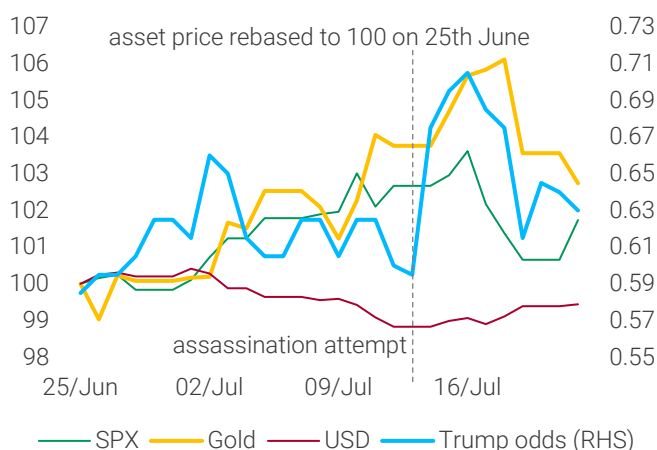


Source: Bloomberg, TS Lombard

## Trump reflation could fizzle out

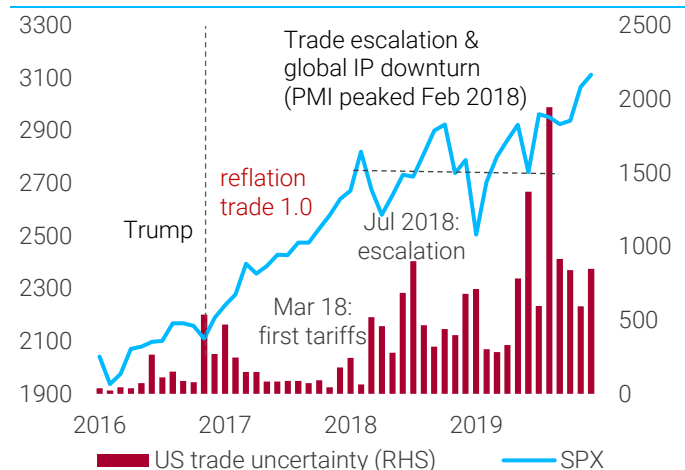
Equity investors' focus on corporate tax cuts seems rather myopic, particularly given some of Trump's other policy favourites – notably, tariffs. Even if Trump 2.0 proves less radical than feared, the mere weaponization of trade uncertainty could be sufficient to kill any post-election rally by mid-2025 (if not sooner). And the reflation trade in bonds would probably fizzle out, too, especially if his tariff threats undermine the global capex cycle (as they did in 2018-19). Funnily enough, this whipsaw pattern would match the patterns we have seen after previous elections. Our strategy team has looked at similar election scenarios in the past, following an incumbent Democratic administration. They found that Republican victories were often greeted with a euphoric market reaction, but that boost typically fizzled out within six months – a very plausible pattern for what might happen this time, too. (Note the re-election of a Democratic incumbent tends to have the opposite effect: a temporary weakness in risk assets, which eventually unwinds. This is pretty plausible scenario for a Kamala Harris election victory.)

Chart 28: Event study supports reflation trade



Source: Datastream, TS Lombard

Chart 29: Tariffs killed the original reflation trade



Source: Trade uncertainty index, TS Lombard

## Beyond 5 November

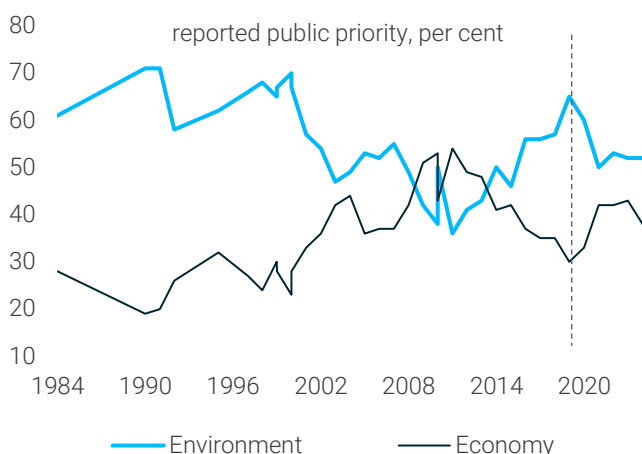
For all the near-term election uncertainties and likely market gyrations, it is important to take a step back and recognize how much the political debate in the US has shifted over the past decade. Win or lose, Trump has set the policy parameters of this election; and there are some things that will not change, regardless of who controls the White House. Perhaps the clearest shift has taken place in fiscal policy, where there is now no real debate about whether budget deficits should remain large or whether fiscal consolidation is necessary. Instead, the only area of contention is about the *composition* of the deficit – whether taxes should be lower or spending higher. In fact, as IMF analysis has shown, this is part of a big global trend, one in which the appetite for fiscal deficits has increased across the entire political spectrum, regardless of left- or right-wing ideology. And we are also seeing politicians everywhere wanting to intervene in the economy in other ways – through tariffs, strategic industrial policies and a renewed emphasis on improving the fortunes of the middle class, strengthening worker power and rebuilding manufacturing. This US election campaign has even seen Republicans fight Democrats on the issue of which party is more “pro-union”, which is a massive pivot from the union-busting Reaganomics of the 1980s. Politics has changed indeed.



## Echoes of the late 1800s

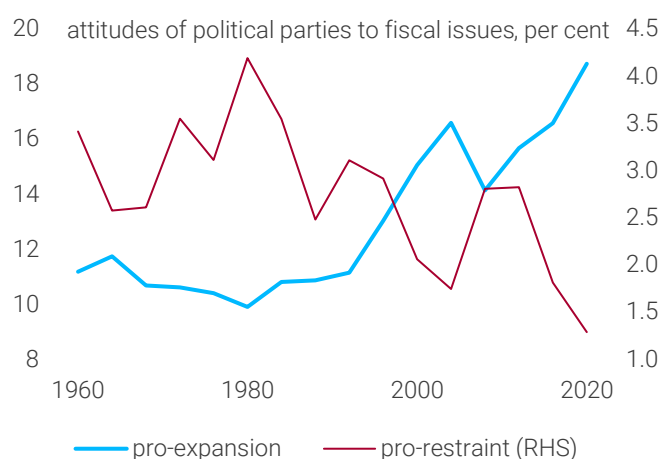
One of the more striking moments of this election campaign came during Trump's July Bloomberg interview, in which he eulogized William McKinley, US President between 1897 and 1901 (when he was assassinated). Trump described him as "the most underrated president", "the tariff king" and the person "who made this country rich". We find these comments fascinating, not because they are an accurate account of history but because, [back in 2019](#), we wrote a lot about how the post-GFC era resembled the [Long Depression](#) of the late 19th century. Recall, the period after 1860 was defined by rapid technological change and fast globalization. It was an era in which capital was dominant over labour, the first of our [three "macro supercycles"](#). And like every macro supercycle, it sowed the seeds of its own destruction, because the collapse in the wage share, extreme inequality, polarization and reoccurring financial instability eventually triggered a political counter-revolution. By the turn of the 20th century – the period of which Trump is so fond – we had the emergence of populism, a swing towards protectionism, the start of the trade union movement and the foundations of the welfare state. The balance of power in the economy had started to shift towards labour and a new macro supercycle emerged. We saw those same trends appear in the 2010s, and the developments of the last decade have supercharged them.

Chart 30: Less appetite for green policies



Source: Gallup

Chart 31: Nobody believes in fiscal restraint



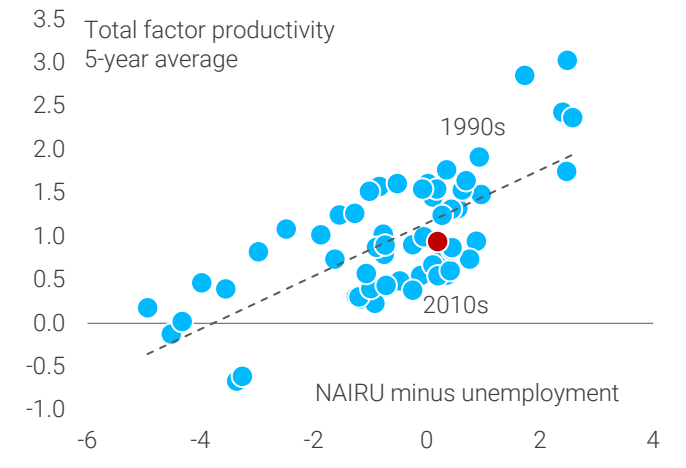
Source: IMF, the Manifesto Project

## The next supercycle

For all the mainstream anxiety about where these political dynamics will lead, we think it is important to remember that 50 years of neo-liberalism cannot be reversed in an instant. Turning our back on Thatcherism and Reaganomics is not going to plunge us straight back into the 1970s or create persistent stagflation. (Although that might be the eventual endgame, because supercycles where labour is dominant probably have a stagflationary bias.) Meanwhile, the US economy has emerged from the challenges of recent years in pretty good shape and is facing any upcoming political test from a position of strong fundamentals. Rather than worry about the stagflationary endgame, which could be decades away, investors should embrace what we call [a "high-pressure" macro environment](#). With tighter labour markets and a more reflationary policy mix, we are likely to see faster productivity, stronger median wage growth and less inequality. Even strategic industrial policy could be beneficial, until the politicians eventually push it too far. And whoever wins this election will inherit an economy relatively free of underlying macro-financial imbalances, with private-sector balance sheets at their healthiest since the mid-1990s.

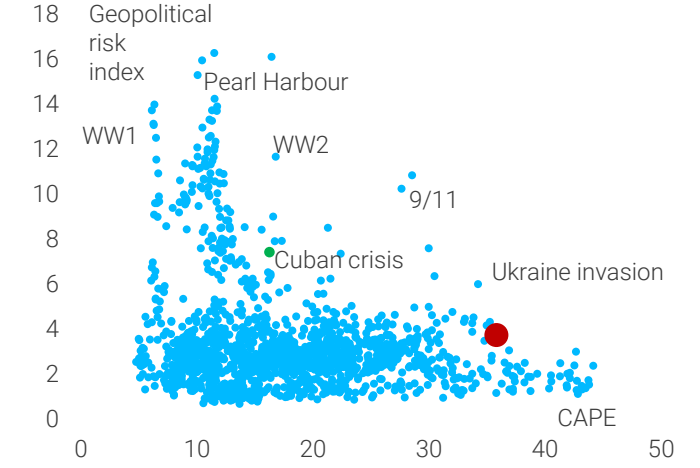
Could political incompetence mess this up? Sure – eventually. But at the same time, we do not need particularly competent politicians to avoid that outcome.

**Chart 32: Higher-pressure productivity boost**



Source: BEA, BLS, TS Lombard

**Chart 33: Return of a political risk premium?**



Source: Shiller's website, TS Lombard

One final point: we have focused on the macroeconomic and market implications of the US election because that is what we do (the clue is in the title – “Macro Picture”). Obviously, there is a lot more at stake, ranging from climate change, international relations, NATO, how the West responds to Putin and the situation in the Middle East. We have no expertise in those areas, and we do not pretend to know how the election result will influence them, or which outcome is “better” for world peace and prosperity. Plus, it is not our job to tell people how to vote.

## Bottom line

While financial markets seem to care only about the near-term prospect of corporate tax cuts and the Trump reflation trade, we are hearing a lot of US election angst from global investors. Not only do we have two candidates who want to run endless fiscal deficits, but they have also proposed a variety of other interventionist measures. With Trump, those threats include large tariffs, mass deportations and his thinly veiled attacks on the Fed’s independence. With Harris, we are looking at a continuation of Biden’s strategic industrial policies, progressive taxation and a potential campaign against corporate “price gouging”. On the fiscal situation, we still feel relaxed about the outlook, particularly compared with the narrative that has taken hold of financial punditry. We see no real prospect of a “Liz Truss moment” in the US, and we do not expect either candidate’s budgetary plans to create a persistent inflation problem. It is other policies – not least the weaponization of trade uncertainty under a Trump Presidency – that pose a bigger threat to market risk premia (including the now notorious term premium in US Treasuries). That is why we suspect any Trump reflation trade would eventually fizzle out, just as it did after 2016. But it is important to recognize that this election marks a further rejection of post-1980s neoliberalism, and it is another confirmation of our long-held thesis – that the macro supercycle has reached an important inflection point. The “good news”, at least for investors, is that half a century of neoliberalism cannot be reversed in an instant. And with the economy emerging stronger from the pandemic, it is premature to worry about stagflationary endgames.

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