LPL RESEARCH

WEEKLY ECONOMIC COMMENTARY

KEY TAKEAWAYS

The degree to which the election results impact volatility will depend a great deal on which policies are actually enacted as a result of the changes in Washington.

Corporate tax reform, including repatriation that allows companies to bring overseas cash back to the U.S. at a discounted tax rate, stands a very good chance of being passed following the Republican sweep.

We do not believe the election results have changed the Fed's outlook.

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EVALUATING THE ECONOMICS OF THE PRESIDENT-ELECT

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The results of the November 8, 2016 U.S. presidential election have not changed our long-term outlook for the U.S. economy. Elections do not in and of themselves change economic trajectories, policies do. We need to wait to see which policies Trump moves forward with and the details of those policies. Our Recession Watch Dashboard continues to point to an overall low risk of recession within the next year.

THE PRESIDENT PROPOSES, CONGRESS PASSES

President-elect Donald Trump, whether you support him or not, won't get everything he campaigned over because the process of lawmaking is a compromise, even within one's own party. All presidents—even those like Trump who sweep into office while holding both houses of Congress—will have to compromise. Why?

Checks and balances are an important part of our political system. Although Trump is not a traditional politician, he will likely share the experience of leaving a fair amount of his campaign agenda undone. Checks and balances help to eliminate the extremes that may be making investors nervous. Further, newly elected presidents tend not to have as much political capital as they think they do, which is one of the reasons they are typically unable to get all of their top priorities accomplished. Trump has a narrow Senate majority, won a closely contested election, and the Republican Party (not to mention the Democratic Party) is fragmented, making the policy path more difficult. Still, he is likely to make a difference in several key areas impacting the economy:

- Taxes, both corporate and personal
- Infrastructure and defense spending
- Healthcare
- Regulation
- Trade and tariffs
- Immigration

In addition, his election may have an impact on the decisions of the Federal Reserve (Fed) this year and over the next several years. We'll address the tax and infrastructure proposals, as well as the Fed, in this commentary, and plan to discuss the impact of President-elect Trump's other economic related proposals at a later date.

TAXES AND INFRASTRUCTURE SPENDING CHANGES ARE LIKELY UNDER PRESIDENT TRUMP

We believe corporate tax reform, including repatriation that allows companies to bring overseas cash back to the U.S. at a discounted tax rate, stands a very good chance of being passed following the Republican sweep. Trump has also proposed to lower the corporate tax rate (from 35% to 15%) and lower the top marginal personal tax rate from 39.6% to 33%. While lower corporate and personal tax rates and a simpler tax code is a plus for the overall economy in general, it may lead to less tax revenue and higher deficits, which may give some fiscal conservatives in Congress pause. However, dynamic scoring of the impact of changes to the tax and spending laws-which account for the feedback of a stronger economy due to the tax cuts, may help to ease fiscal conservatives' concerns.

In broad terms, the key aspects of Trump's proposals on infrastructure spending—which his campaign puts at as much as $1 trillion—differs from the $787 billion fiscal package passed by President Obama and the Democratic House and Senate in 2009. The infrastructure portion of the 2009 stimulus package relied on federal government grants to the states for infrastructure projects like road and bridge repair. The Trump proposal relies on tax credits that would incentivize the private sector to spend on infrastructure.

It's worth noting here that the $787 billion plan passed into law in 2009 by President Obama and the Democratic House and Senate was well below the initial proposals made by Obama on the campaign trail, reinforcing the notion that Congress can often act as a :check" on a President's power.

FEDERAL RESERVE REMAINS ON TRACK TO TIGHTEN IN DECEMBER

We do not believe the election results have changed the Fed's outlook. Furthermore, we believe the Fed is much less sensitive to financial markets than most people think. As it stands, we believe the Fed is on course to increase rates at its December 2016 meeting, with another 2-3 increases in 2017. It would take a major market disruption or a change in the economic fundamentals for the Fed to alter this course.

Congress granted the Fed authority to run the nation's monetary policy, and any changes to the structure or independence of the Fed would therefore have to emanate from Congress. The chair of the Fed, a seat currently held by Janet Yellen, is appointed by the president and confirmed by the Senate. Fed Chair Yellen's term as Chair ends in February 2018. Yellen was appointed by President Obama in late 2013 to replace Ben Bernanke as Fed Chair.

APPOINTMENTS AND RE-APPOINMENTS

In the past 35 to 40 years, Fed chairs appointed by the president of one party have been re-nominated by presidents of the other party, helping to keep the Fed largely "above the fray" of the political wrangling in Washington. For example, Fed Chair Paul Volcker was appointed by Jimmy Carter—a Democrat in the late 1970s—and reappointed by Ronald Reagan, a Republican in the early 1980s. Reagan appointed Alan Greenspan to be Fed Chair in the mid-1980s, and Bill Clinton—a Democrat—reappointed Greenspan in the 1990s. George W. Bush appointed Ben Bernanke to be Fed Chair in the early 2000s, and President Obama reappointed him in 2009.

Looking ahead, President-elect Trump has said conflicting things about Janet Yellen in recent months, so it's unclear today whether or not he would reappoint her as chair when her term is up in 15 months. Trump will also be able to immediately nominate candidates to fill at least two vacancies on the Fed's 7-member Board of Governors, and since the members of the Board are appointed to 14-year terms and are also voting members on the Fed's policy-making arm, the Federal Open Market Committee (FOMC), those candidates may impact monetary policy for years to come.

RISE OF ECONOMIC VOLATILITY?

We expect a potential increase in market volatility in the coming weeks and months, and economic volatility may also increase, as well. Economic policies that have been in place since the start of the Obama Administration in 2009—and in some cases, well before that—may be changing in the next few years. Consumers, businesses, policymakers abroad, and market participants will need to adjust to these changes, which may lead to elevated levels of both financial market and economic volatility. However, we point out that the degree to which the election results impact volatility will depend a great deal on which policies are actually enacted as a result of the changes in Washington. ■

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