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Trump Policies: The Only Certainty is Uncertainty

As we assess the potential impact of President Donald Trump's economic policies on financial markets – particularly within fixed income – we must recognize both the stimulative and contradictory aspects of his agenda. Trump's economic playbook, broadly speaking, focuses on tax cuts, deregulation, protectionist trade policies and energy independence. All of these, in our view, could have varying effects on economic growth, inflation and the fiscal deficit.

Pro-Growth Policies with Inflationary Risks

Trump's policies include aggressive tax cuts and deregulation, particularly in the energy sector. Both tactics could provide a near-term boost to economic growth by increasing corporate profitability and incentivizing investment. A return to deregulation in banking, energy and healthcare, as seen during the first Trump administration, also has the potential to spur business expansion and merger and acquisition (M&A) activity, in our view.

However, alongside growth-supportive policies comes an inflationary tradeoff. The combination of tax cuts and "America First" trade protectionism could create cost-push inflation by raising input costs for US manufacturers and consumers. Consensus on how Trump will wield his tariff authority is lacking. Some insist it is a negotiating ploy, and others think the administration is in favor of using universal tariffs to reset global trade and raise federal revenues. We believe that both strategies are likely to occur to some degree. A more protectionist stance on global trade would put upward pressure on consumer prices and complicate the Federal Reserve's (Fed) ability to manage inflation.

Immigration policy could also pose a challenge to achieving strong economic growth while maintaining tame inflation. Over the long run, gross domestic product (GDP) growth is constrained by labor supply and productivity gains. Discouraging immigration could strain a labor market that is already fairly tight, in our view. Trump appears to believe that his deregulation policies will lead to a productivity boom that would require a massive deepening of capital and technology gains. Expansion of artificial intelligence (AI) may be the answer. If not, we believe a tight labor market could restrain growth or lead to wage inflation that could reverberate back into the general level of prices in the economy.

Contradictory Fiscal Policy: Stimulus vs. Deficit Expansion

The most concerning aspect from a fixed income perspective, in our opinion, is the growing fiscal deficit. Trump's policies favor lower taxes and higher spending on defense, infrastructure and possibly social benefits designated for certain demographic blocs. The US debt trajectory is already concerning, with deficits exceeding $1.5T annually. If Trump implements further tax cuts without corresponding spending reductions or revenue increases, we believe debt-to-GDP could continue rising and potentially force the Treasury to issue more debt at higher interest rates. This increased supply of bonds could steepen the yield curve, push real rates higher and create volatility in fixed income markets.

The current administration seems to grasp the vital importance of the government's fiscal position. Elon Musk and his Department of Government Efficiency (DOGE) have been established and are researching various departments and agencies in a bid to sharply reduce spending and waste. It is unclear if DOGE's efforts will put a material dent in the deficit given the bulk of the government spending comes from entitlements, defense and interest on the US debt.

Trump has touted tariffs as a way for the government to raise a massive amount of revenue. This would require the implementation of a fairly steep universal tariff. Tariffs function as a tax on imports, and the costs are typically transferred to consumers and businesses through elevated prices. They can also provoke retaliation from trading partners. Trump says these will force businesses to invest and produce items within the US. In any case, economists generally see tariffs as being a disruptive force in the economy as they can boost inflation while making business planning difficult.

The Fed's Role: Policy Tightening or Forced Accommodation?

If inflation remains persistent due to fiscal expansion and trade disruptions, the Fed may be forced to maintain higher-for-longer interest rates, which could pressure both risk assets and government borrowing costs. However, Trump has also been vocal about his preference for lower interest rates, and could attempt to politicize the Fed, thus creating uncertainty about the future of monetary policy independence.

Bottom Line: Fiscal Deficit is the Achilles Heel

Trump's policies may provide a short-term boost to growth, but the fiscal deficit remains the key long-term risk, in our view. While markets may react positively to tax cuts and deregulation initially, persistent deficit-driven Treasury issuance could pressure bond yields higher, creating headwinds for fixed income investors. The success of Trump's economic plan may ultimately come down to reining in the government deficit. A failure to do so could reignite inflation fears and unleash the bond vigilantes, who have a history of intimidating even the most quarrelsome politicians.

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