January 24, 2025 – Implications of the New Trump Administration for the Economy and Markets

David Hagee: Hello and welcome to Conversations with Commerce Trust. Our show about the markets, investment themes, and economic insights that matter to you. I'm your host, David Hagee, Chief Investment Officer with Commerce Trust.

Today we're discussing the implications of the new Trump administration with Scott Colbert, our Chief Economist and Director of Fixed Income here at Commerce Trust.
Welcome back to the podcast, Scott.

Scott Colbert: Thank you, David. Happy January.

David: Yeah, happy, cold, cold January here in the Midwest.

So it's been an eventful week. We had the inauguration here in January and we've had pretty active five days here with some of the new ideas coming down from the new Trump administration. You and I have talked about this a little bit. As we're starting to refocus our lens on 2025 and exactly what these first 100 days could look like for the new Trump administration, it roughly boils down into four different categories, tariffs, taxes, immigration and policy. First start with tariffs. Certainly it has been in the news on the campaign trail. We had a lot around this. What are your thoughts on the impact of tariffs on the U.S. economy?

Scott: Well, it's been the one area that they haven't jumped on quickly. There's already been 100 executive orders, plus or minus, and not one of them has to do yet with tariffs. Although, by February 1st there's supposed to be some movement on tariffs.

I think it's important that investors know that there's three focuses that Trump has with regard to tariffs. Number one, he wants to use them to help bring products home, particularly for unfair trade practices. Number two, he wants to raise revenues. He might need those revenues to offset some of those tax extensions that he'd like to provide to the economy. And then number three he wants to use these tariffs as leverage with regard to negotiating things like tighter immigration, less drug flow. With regard to Canada, he'd like to see more American assembly, less of it up in Canada. And with regard to China, it's fairly broad-based and largely from a national defense perspective.

David: As we review those tariffs, you're looking at roughly 10% on all Chinese goods, a little bit more on Mexican and Canadian goods. As we talk about that, what's the economic impact on that for both inflation as well as economic growth?

Scott: Wall Street is somewhat circumspect about, you know how it's going to impact the economy. I think without a doubt, it's likely to be at least near term inflationary. We know that about 2% of our goods and services comes from (each) China, Canada and Mexico so 6% of GDP (Gross Domestic Product) is imported. So if you add 10% to the cost of 6% of the economy that's a 60 basis point increase in the cost of goods and services this year. And of course, the Federal Reserve would like to see, you know, inflation coming down. Frankly so would the Trump administration, they've promised to bring inflation down. In terms of their impact of the stock market, to the extent that you know it brings us closer to a trade war or it makes things more difficult for businesses to operate, I don't think it's going to be great for the S&P 500 (Index) either, and I think Trump used the S&P 500 as you know, one of the markers of his presidency.

David: Yeah tariffs, as we see it today will be slightly inflationary, not necessarily persistent inflation. What sort of space does this give the Federal Reserve to continue on the rate cutting cycle or is this stalled out now because of the potential inflation you'd see from higher tariffs?

Scott: No, it's absolutely stalled out as the Federal Reserve, you know, wants to see what policy is likely to be and then adjust accordingly. Sometimes the Federal Reserve (Fed) works with the government if they're all pulling in the same direction, and sometimes they're counter-cyclical.

For example, all the deficit spending that's been driving the deficits higher, this has been one reason why the Fed has been very, very slow to cut rates so far when they were fairly restrictive a year or two ago. They have provided 100 basis points of interest rate reduction so far. There is room to provide more in the long run, but they're cautious right now. I think by the end of the year though, they'll have a clearer understanding of what policy is likely to be and the impact to the U.S. economy and possibly then afford a rate cut or two late in the year.

David: The next area, tariffs, will raise a little bit of revenue. Not enough to really make a dent into the current deficit spending that we do have, but another big pillar for Trump moving forward in this first hundred days is the extension of the 2017 tax cuts from his first administration. As we look at it today there was word out of Davos (The World Economic Forum) that he was interested in lowering corporate tax rates even further.

What's the impact of the Trump administration on taxes and how does that bleed into the economy?

Scott: Extending the current tax policy is likely to be accretive to the deficit so they are looking for ways to save money to offset some of the likely increase in the deficit from just extending things as they are. But in addition to that, Trump has also suggested potentially lowering the corporate tax rate for companies that operate within this country from 21% to 15%. Now corporate taxes aren't a huge amount of the tax revenue, but nonetheless, any reduction is likely to be a reduction in revenue, not offset by the way, of increased growth.

Secondly, he's thrown out a couple items, for example, not taxing social security benefits, not taxing overtime (pay), and then probably as a negotiation tool to get his Tax Cuts and Jobs Act extended increasing the so-called SALT deduction, state and local tax deduction that is capped right now at $10,000 (annually) to help get this passed.

All this, though, is likely to be accretive to the deficit, and I think that's the biggest driver that's kept longer term interest rates higher despite the fact that the Fed has been cutting interest rates starting mid-September last year.

David: Moving on to another key pillar for Trump in the first 100 days - immigration. This by far was his most persistent message on the campaign trail. We had a lot of immigration under Biden. I think that fed directly into the jobs market that we saw pretty consistent growth around a little less than 200,000 jobs per month.

What do we see as the policies emerging inside the Trump administration regarding immigration and what are the impacts for the U.S. economy?

Scott: Well, there are three key areas of focus that Trump has on immigration. Number one, is stiffening the border. And he has bipartisan support to get that done so this is basically a tighter border in general. They are going to accelerate deportations. And then the final thing is, there is debate within the administration, largely coming from corporate America, that there is still a number of high-tech skilled type folks that provide important services to this country that we would like to have those visas provided to. Three areas are tightening the borders, accelerating deportation, and negotiations with regard to additional visas.

In terms of the impact to the economy, the number one driver to gross domestic product is - countries that do not grow demographically from a population perspective have very, very slow growth rates.

So one of the biggest reasons we've been able to grow as fast as we have is the relatively large amount of immigration. It did surge over the last four years relative to where it had been. I think that helped us keep the unemployment rate steadier. The biggest reason that it's even increased at all is largely due to the additional immigration. But to the extent that we want to grow, we're facing a demographic cliff because birth rates fell considerably during the subprime (mortgage) crisis (between 2007-2010).

David: So the final area we want to talk about is changes in policy. I think this hits broadly in a couple of areas less regulation going on, we have the DOGE, the Department of Government Efficiency, looking for government waste and redundancy. And then finally, we have pro-growth policies that would be around easier, less red tape type of situation.

What are we thinking in terms of the policy changes that we're going to see and then their economic impacts?

Scott: We're very positive on the less regulation. I think Trump's banking on that to offset some of the headaches he's likely to provide to corporate America. We think the policy areas are largely focused in four areas. Bank and finance, perhaps some stress tests to basically open up capital and allow lending to flow a little more freely. It's clearly focused on oil and gas exploration at the expense of clean energy and climate change. Easier permitting.

The proposed head of the SEC (Securities and Exchange Commission), as well as his national economic adviser very pro crypto (cryptocurrency). And then finally, you've got just the reduced regulation is likely to increase merger and acquisition across the spectrum and this is one reason why we like middle-cap type companies because we think they're likely to be targets from the largest cap companies that have currency to work with, that is their expensive stock price, to reach down in capitalization and add to their growing empires.

David: So if we distill all this together, you've got the tariffs, taxes, immigration, and policy changes coming through. And we anticipate a lot of activity here in the first 100 days of the new Trump administration.

What does this mean for economic growth for 2025 and its impact on interest rates as well?

Scott: We [Commerce Trust] boosted our growth outlook when Donald Trump won the presidency.

The fact the stock market's held up so well, and while interest rates have backed up a touch, they haven't backed up so much to cool economic activity.

In terms of interest rates though, it is probably likely because a lot of this pro-growth strategy is deficit-financed or likely to be deficit-financed, increases the number of treasury bonds that we have to finance, also then likely increases or at least holds up the longer-term interest rate market. If you're a bond investor, the yield on the aggregate market right now is about 5%, which becomes competitive perhaps to the stock market, and of course, we expect returns from the stock market to slow down.

We still think the stock market beats the bond market. It's caused us to look more domestically from an equity perspective largely because of the strong dollar and our larger tech industry relative to the rest of the world. And then of course, as we just mentioned somewhat down in capitalization because that's where we think the merger and acquisition candidates and the premiums that we'll pay for companies are going to come from.

David:
Thanks for the interesting conversation today, Scott. Really appreciate it.

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Thank you for joining us on Conversations with Commerce Trust. I'm David Hagee. We'll talk again soon.

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