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The economic consequences of Trump 2.0

Trump's agenda thrives on sensational headlines and political grandstanding. Real change usually fails to materialise — with one exception

US President-elect Donald Trump's second administration starts at noon on 20 January. Trump's non-stop election campaign since losing to Joe Biden in 2020 suggests a better organised redo of his first term, with the same focus on tax cuts to boost the economy, higher tariffs to reshape US trade with the world and deporting as many immigrants as possible to generate more opportunities for American workers. But times have changed, and reality is unlikely to match rhetoric.

In 2016, when Trump first won the presidency, the United States was experiencing a prolonged period of low inflation. The Federal Reserve kept interest rates near zero throughout his administration. This time, however, is quite different. Inflation spiked during the Covid-19 pandemic, and the Fed is still on guard against a resurgence — hence interest rates remain relatively high. Trump's proposed tax cuts imply a fiscal stimulus for an economy with low unemployment. Any signs of overheating will be met by tighter monetary policy.

Trump has made noises about changing the leadership of the Fed, but he cannot fire Fed Chair Jerome Powell without risking both higher long-term interest rates and higher inflation. There will be tax cuts in 2025, mostly for rich people, and the consequent loss of revenue will undermine long-term fiscal sustainability. Larger deficits will keep interest rates higher than they would be otherwise, and the dollar may strengthen, creating difficulties for US exporters and for countries that have borrowed in dollars.

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On tariffs, the world's leaders (and financial markets) have come to understand that Trump talks loudly and carries a pretty small stick. He will no doubt noisily impose some high-profile tariffs, but US business interests will

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immediately begin seeking loopholes and lobbying for exceptions. Foreign leaders will make the pilgrimage to Mar-a-Lago, play some golf and negotiate mutual carve-outs (we won't tax your bourbon, if you don't tax our cognac, and we'll buy more US-made air defence systems).

Trump could ignore all this special pleading and insist on higher tariffs across the board. But that will bring more retaliation from trading partners and more protests from the big companies that now back him. The last thing Trump wants is to cause domestic job losses, which could happen if US-based companies must pay more for imports and lose competitiveness in export markets. If foreign leaders don't make him look bad on the golf course and emphasise the jobs their companies create in the US (particularly in Republican-controlled states), everything will be up for reasonable discussion.

On illegal immigration, Trump is sure to have impact. The 'border wall' is an illusion with no real meaning. But Trump is already threatening to punish Mexico and other countries (even Canada!) with high tariffs and other measures unless they hold back immigrants, and this will have some effect. Trump may also be clever enough to relax US sanctions on Venezuela, allowing more oil onto the world market and also helping the Venezuelan economy. That would reduce pressure on Venezuelans to emigrate, while also squeezing Iran and Russia (both of which rely on oil sales to finance purchases of electronic parts from China for use in weapons).

Trump could go further by rounding up and deporting millions of people who are in the US illegally. But mass deportation would harm major sectors of the economy (such as agriculture and construction), fuel massive social disruption and cause his business allies to cut back on their investments (and job creation). Again, we should expect to see political grandstanding and sensational headlines, but the reality will not be much changed (illegal immigration has already fallen).

So, what will Trump really do?

Will he purchase Greenland (or Canada!) or somehow reacquire control over the Panama Canal or reduce US support for NATO? None of Trump's recent statements on these topics are meaningless, but nor should they be taken literally. Again, Trump wants to get what he considers (and what he can portray as) a 'better' deal for the US. If he doesn't say what that means now, it just means he is open to suggestions

— or he can just define whatever the end point turns out to be as a strategic victory.

That's what happened during Trump's first administration, when NAFTA (the North American Free Trade Agreement) was renegotiated with Mexico and Canada. Trump had originally threatened to tear up NAFTA 'on day one'. Eventually, he settled for small modifications (including amending the rules of origin in a way that was acceptable to all sides) and a rebranding that turned NAFTA into the USMCA (the United States-Mexico-Canada Agreement).

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A broader reshaping of the world is afoot, but this has nothing to do with the incoming administration, which is unlikely to respond effectively. For example, Trump is still using bellicose language about confronting China and Iran, but both are already in bad economic shape and hardly pose a threat to regional order — let alone international peace. And, as he did in his first administration, Trump promises to withdraw from foreign interventions (Afghanistan and Iraq then; Ukraine now). But Russia's need for drones and missiles to launch at Ukraine has made President Vladimir Putin fully subservient to China. Does Trump (and the Republican Congress) really want to hand a weakened President Xi Jinping an illegitimate and bloody victory in Ukraine?

What American voters really care about is good jobs and the cost of living. But Trump's 'populist' agenda – a smoke-and-mirrors program, sustained by fear of imagined enemies – is a failure foretold. Trump inherits a strong economy, but his signature policies will do almost nothing positive for less-educated workers or significantly improve the lives of most other Americans. Instead, the rich will get richer, the richest will get a *lot* richer, and everyone else will most likely struggle with higher inflation, cuts to public services and the effects of runaway deregulation.

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