Dive-In

US Elections and implications of Trump 2.0

GenAM Macro & Market Research

US election: risks for trade, persistently high fiscal deficit very likely

Regardless of the outcome, incentives to temper fiscal deterioration are weak

- In a tight and still highly uncertain race and with 7.5 month still ahead, current odds are tilted towards a **Trump victory;** House even closer to call.
- GOP calls to fight foreign tariffs penalising US exporters: otherwise, **higher US import tariffs have been touted** (60% on China, 10% on other trade partners). The impact on the US economy should be smaller and shorter lived than that on larger exporters like China and Germany. The threatened walk out from the WTO could upend the global trading system. A Biden win would mean that current restrictions remain in place
- **Regardless of the winner, no fiscal consolidation is in sight**. The expiration, at the end of 2025 of the corporate tax cuts and household entitlement programs, gives scope for a grand bargain to extend both.
- Trump talked about trimming Medicare/Medicaid, but these are very popular among his voters. **More tax cuts are possible if Rep wins the White House and Congress.** The Biden platform points to a small reduction in fiscal deficit: further increase in expenditure would be more than offset by higher taxes on corporates and high-income earners.
- **The Trump program calls for a repeal of the Inflation Reduction Act**, or a significant redirection of funding away from environmental action.

Source: Oxford Economics, GenAM

- With only a reciprocal increase in tariffs, the associated inflationary effect would lead to a moderate **US yield increase** (relative to the base scenario). If tariffs are combined with tax cuts, we forecast yields to move sideways over the year, with the yield curve to steepen and a wider transatlantic spread.
- FX: **A Trump victory would likely boost the USD on rising uncertainties** (policy & geopol.) and US tariffs (higher inflation initially, FDI inflows). Tax cuts after a 'red sweep' would additionally foster capital inflows into the US.
- Equity markets tend to rally after the election. **Tariffs would raise risk premia for Korea, China and other EM heavy exporters.**

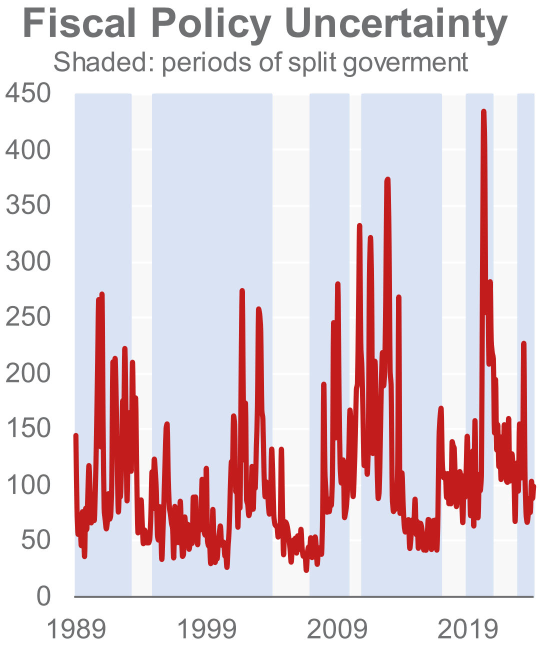
Possible scenarios (in rough order of likelihood)

High chances of split government temper risk of disruptive measures

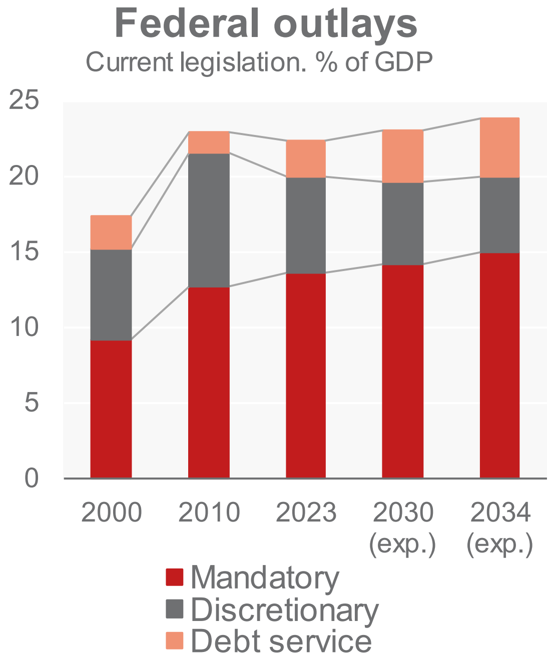
	WH	House	Senate	Trade	Budget	Climate
Trump Elected Split Congress	R	D	R	Tariffs can be imposed, WTO membership at risk	Existing measures expiring in 2025 extended, very low risk of accident on debt ceiling	IRA remains but no further regulation possible
Biden Elected Split Congress	D	D	R	Tariffs stays at the current level. Restrictions on China may be stepped up	Existing measures expiring in 2025 extended, risk of accident on debt ceiling	
Biden Elected Rep- Congress	D	R	R	Tariffs stays at current level. Restrictions on China may be stepped up	Existing measures expiring in 2025 extended, very high risk of accident on debt ceiling	IRA remains but at high risk of scaling back.
Republican Sweep	R	R.	R	Tariffs can be imposed, WTO membership at risk	Corporate tax cuts possible. Cuts to Medicare possible but unlikely	IRA scaled back/repurposed. U-turn on fossil fuels regulation
Democrat Sweep	D.	D	D	Tariffs stays at the current level. Restrictions on China may be stepped up	Higher taxation on corporations, wealthy households. Extension of social security programs.	IRA maintained. Climate regulation stepped up.

Fiscal policy: No incentive for consolidation

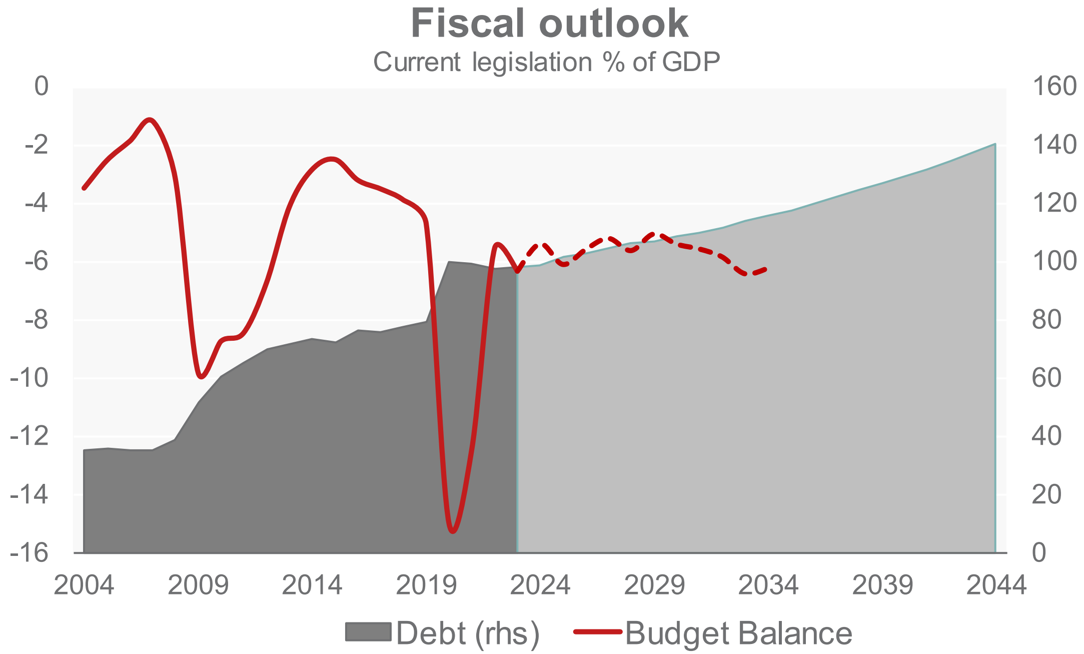
Bipartisan compromise on deficit increasing measure likely in case of split Congress.



Source: Baker, Bloom et al., GenAM



Source: CBO, GenAM



Source: CBO, GenAM

- In case of a split government, a **bipartisan agreement can be found to extend to beyond 2025 the Rep-sponsored 2017 corporate rate cuts and the increase in household entitlement legislated under the Biden administration**. However, in case of another term for Biden, the recent experience shows that **a split government increases the risk of no agreement on debt ceiling** and the federal budget.
- **A Republican sweep would increase the chances of an expansion of the tax cuts.** The hit on the budget would be of around 1.3% of GDP. Offsetting cuts to discretionary spending and social security are in theory possible but not palatable politically.
- The degree of polarisation **makes an agreement to stabilise debt nearly impossible**. Higher taxes are possible under a very unlikely Dem sweep. The increasing weights of debt servicing costs and mandatory spending would further reduce the scope for expenditure cuts.

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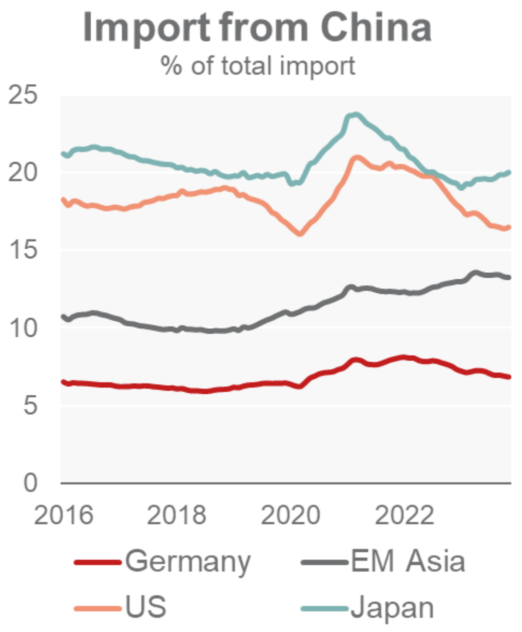
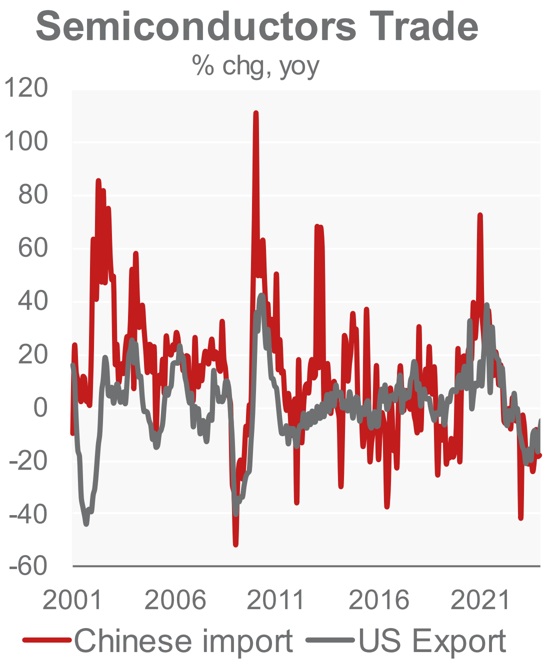
Trade: tariff threat under Trump but decoupling with China would also continue under Biden

Trump team touted measures to force trade partners to reduce tariff asymmetry. WTO membership at risk.



Source: IMF, GenAM

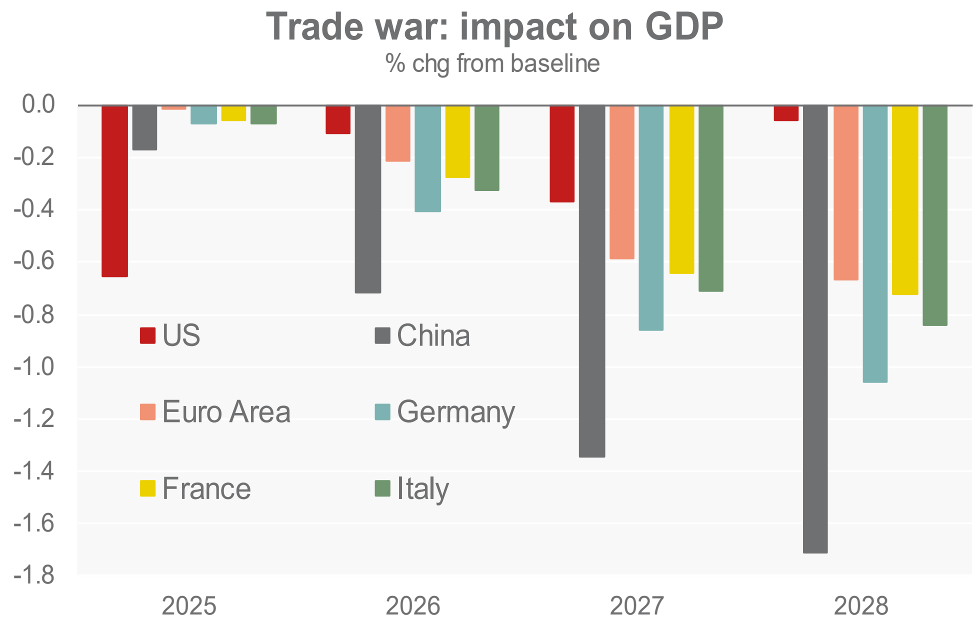


Source: Refinitiv, GenAM

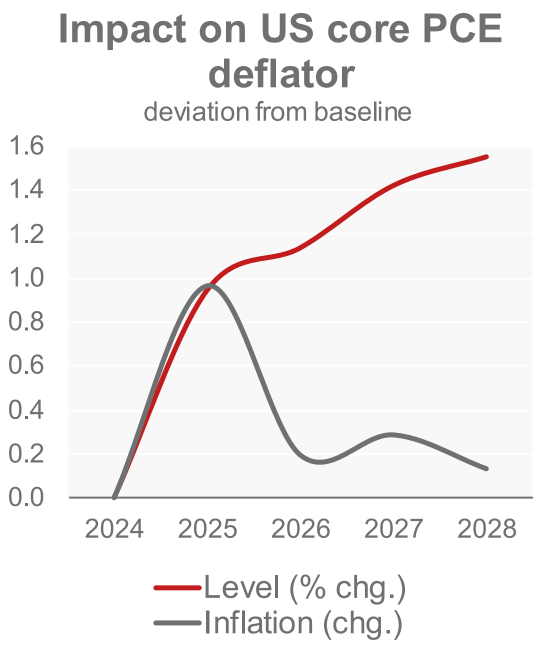
- Trump complains about the high tariffs several countries impose on US imports, which are thought to cause bilateral trade deficits. If they are not scaled down to the lower level imposed by the US**, further sanctions could be imposed**. In an extreme case sanctions on China could be lifted to 60% and to 10% to the other main partners (incl. Mexico and Canada). **The threatened withdrawal from WTO could become concrete.**
- **Action on trade does not require approval from Congress, and a split governed would not be an obstacle.**
- **US decoupling from China has continued under the Biden administration and his stance has not softened**. Bashing China remains popular, so even under a second Biden term restrictions are likely to remain high and even tighten in some sectors (semiconductions)

Trade: a tariff war would harm trade partners more than the US

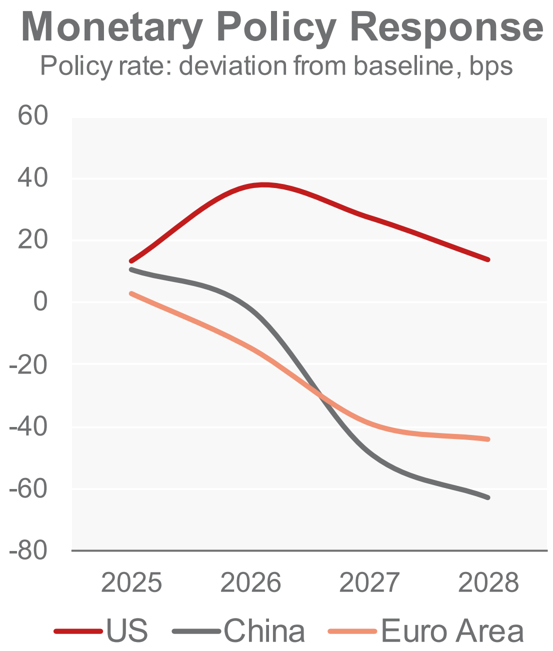
Tariff revenue recycling into the economy would offset much of the hit, but US inflation would rise



Source: Oxford Economics, GenAM



Source: Ox. Econ. GenAM

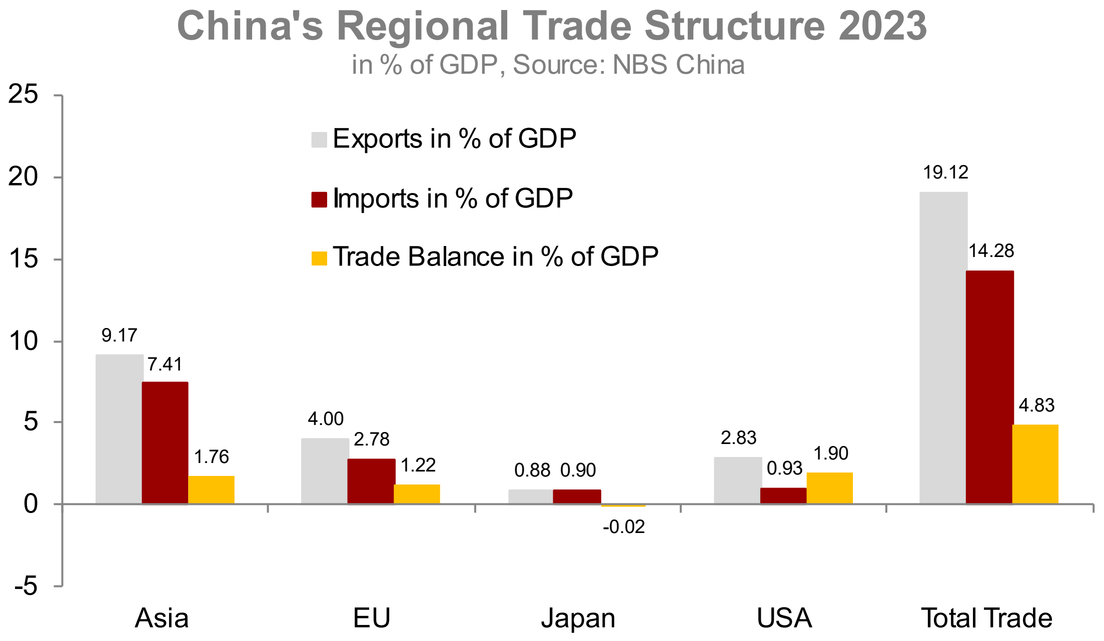


Source: Ox. Econ, GenAM

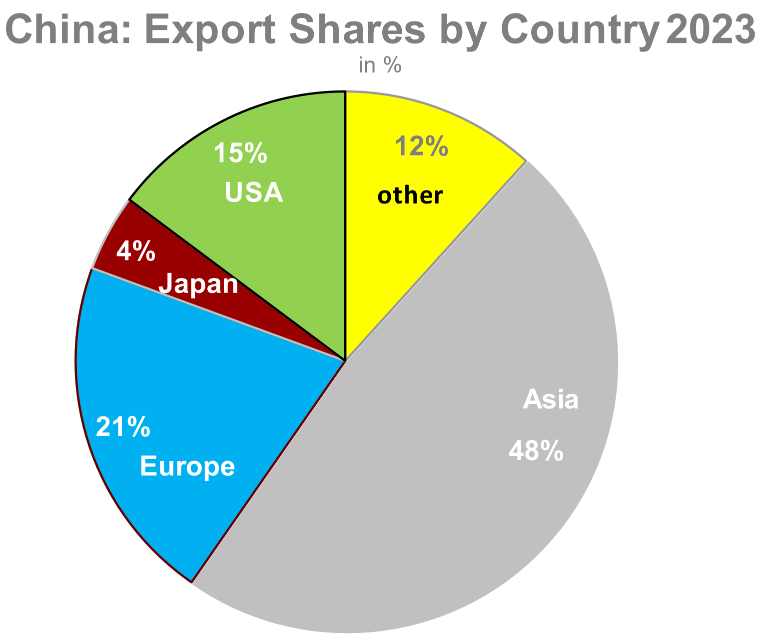
- According to our simulation, **the US would "win" a tariff war consisting in the increase of tariffs to 60% to China and 10% to EU and the main trade partners**, **followed by a same-sized retaliation**. After a strong short-term impact, the recycling of the large extra fiscal revenues from tariffs (1.3% of GDP) into the economy would gradually provide an offset.
- **However, inflation would rise** on higher import costs and a mix of higher expectations and still strong demand. Despite the slowdown in activity, **the Fed may then be forced to cut rates at a slower pace.**
- **Outside the US, the GDP hit would be larger and longer-lived**, with revenue recycling providing a limited respite. Within the Euro area export larger exporters (Germany and Italy) would suffer. The inflationary impact should be minimal, and **the ECB would then respond by accelerating easing.**

China-US trade structure 2023

The US is still an important trading partner, but its significance continuously softens



Source: Datastream, GenAM calculations



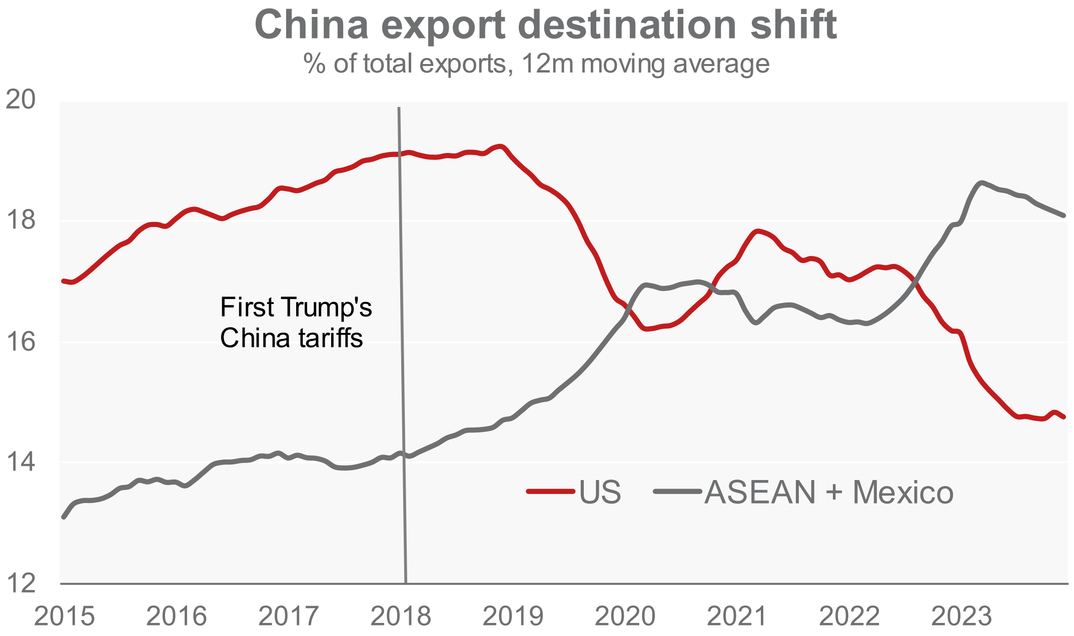
Source: Datastream, GenAM calculations

- From the US perspective, China is the most important source of imports (US$ 427 bn, 1.6% of US nom. GDP), but ranks third (US$ 152 bn, 0.6% of nom GDP) as export destination after Canada/Mexico. The US trade deficit with China is about 1% of US GDP, and the total CA deficit differs only marginally.
- From the China perspectives, the US is the most important single export destination, but Taiwan is more important in imports, the US follows with an import share similarly to Japan. China trade data differ much from US sources. Exports to the US amount to 2.8% of China's GDP (US$ 506 bn), imports (US$ 166 bn) are 0.93% of GDP, and the trade surplus is 1.9% of GDP.
- However**, Asia is the most important trading destination for China's goods, followed by Europe**. While the importance of the China-US trade surplus has diminished over time, substantial trade frictions would be a hit to China's growth.

China mitigated the 2018 tariff impact well, but this time it would be more damaging

Compared to 2018, the tariff could be 4.8x higher, but the bilateral trade balance in terms of GDP has halved

Source: Datastream, GenAM calculations



Source: Datastream, GenAM calculations

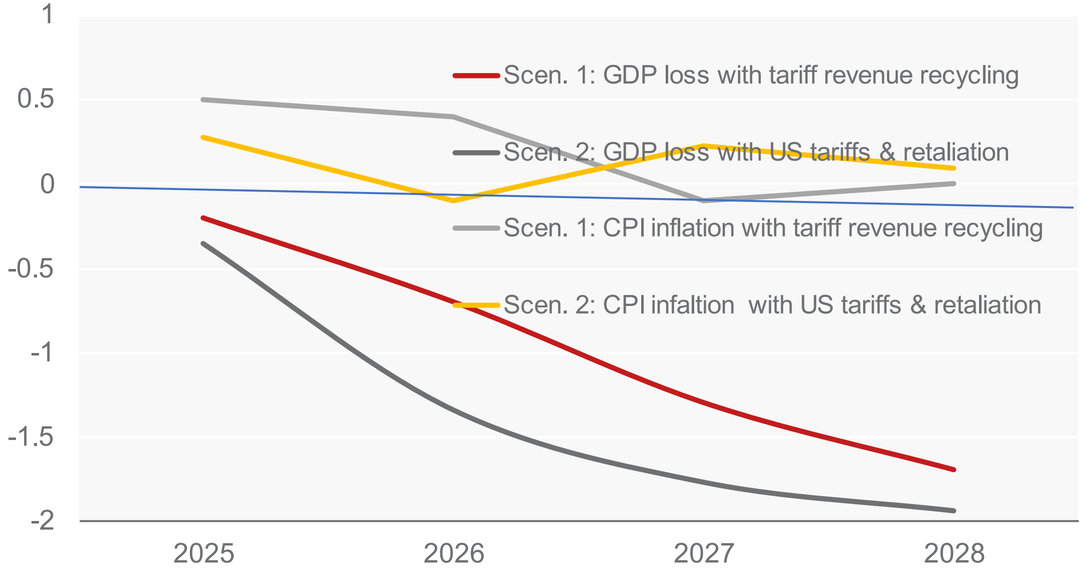
- **Trump is considering stripping China of its "most favoured nation" status, which could result in 60% of tariffs on all imports from China.**
- Following the 2018-imposed tariffs (eff. tariff rate of 12.5% after the Phase One deal, 25% tariff \$250 bn of imports, 7.5% tariff \$112bn), the US-China bilateral trade balance dropped by 0.6 pp of GDP and another 0.3 pp in the 2nd year. This time, the tariff could be 4.8x higher, but the trade balance in terms of GDP has halved.
- A 60% tariff on the 2023 export value amounts to US\$ 256 which exceeds the total of China's imports from the US of US\$ 147 bn. Thus, **retaliation would be limited.** Certainly, agriculture goods from the US would be prime victims. **China could also resort to other measures like reduce exports of rare earths**.
- China was able to mitigate the 2018 tariff impact by: 1/ **a substantial depreciation of the RMB** by about 12% (until Jan. 2020). 2/ **exports were re-routed** via other countries 3/Tariffs concentrated on intermediate inputs. We see US enforcement higher and a general 10% tariff will make rerouting more difficult.

China's GDP could suffer 1.7 pp medium-term, but fiscal & monetary policy would be eased

The impact on CPI inflation is less significant, PBoC to ease and let RMB depreciate

China growth and inflation in response to US tariffs

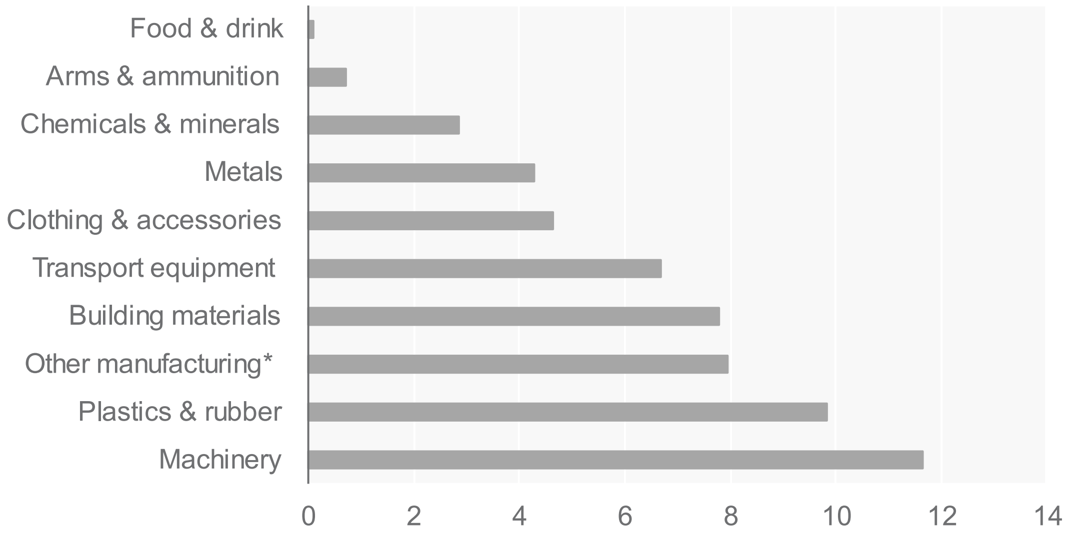
pp against base line



Source: GenAM calculations

China goods exports by sub-industry

change in global market share between 2006 -2022, in pp

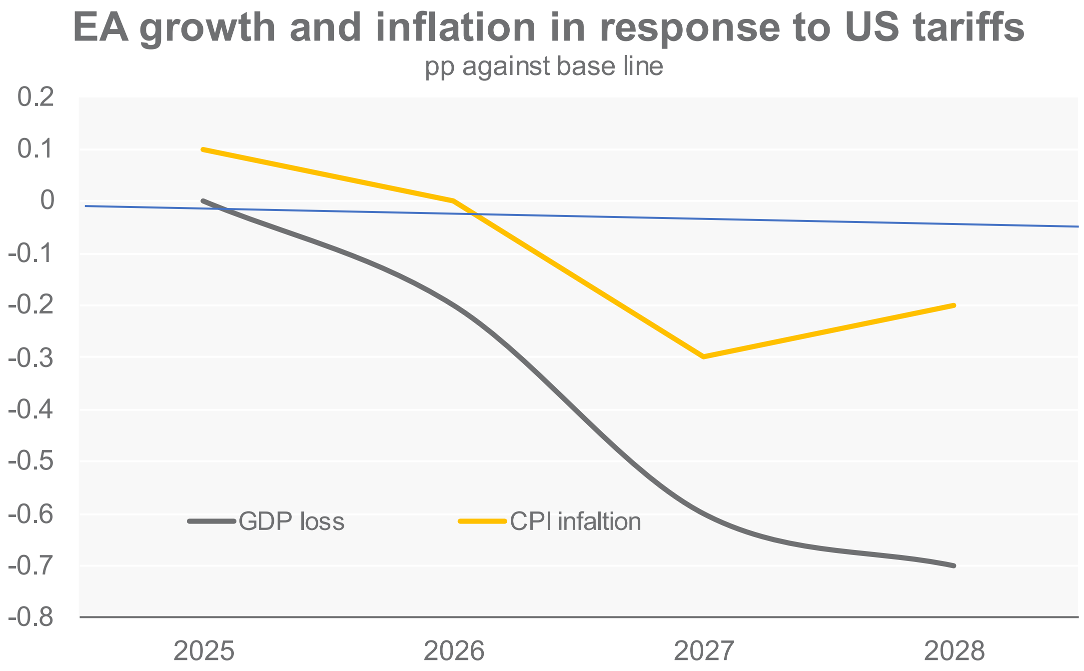


Source: Datastream, Fathom Consulting, GenAM

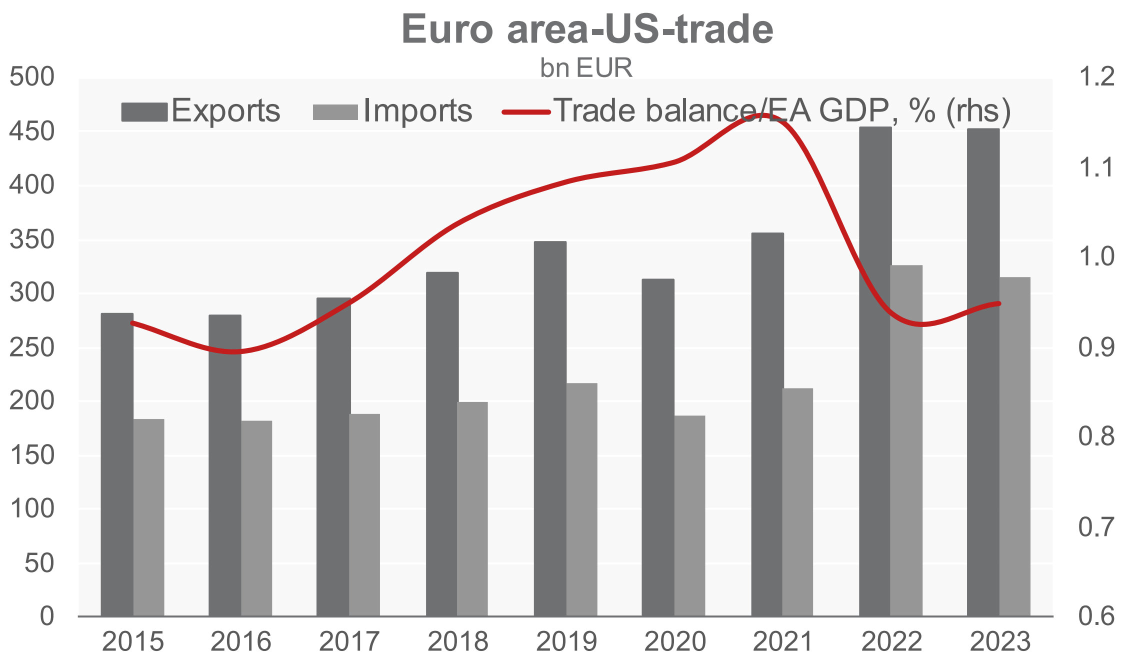
- A first model result (60% tariff + retaliation + tariff revenue recycling) brings a negative GDP impact for 2H25 (assuming tariffs start in H2) of 0.9 pp in the first 1.5 years and 1.7 pp medium term (2028). **Without tariff recycling, GDP loss would be about 2pp**, broadly in line with the 2018 experience calibrated on higher tariffs but lower export dependency.
- Against this background, we see fiscal and monetary policy to respond. China would tend to strengthen its domestic demand via the private consumption channel. PBoC would **cut rates** and allow **RMB to depreciate**. Trade deflection would lead to price pressures on int. goods and elicit more trade conflicts with EU & Japan.
- Trade deflection would also result in downward pressures on domestic CPI inflation, while retaliation and the depreciation largely "neutralise" impact.

EA's growth could suffer about 0.7 pp medium-term, but ECB would cut ~50 bps

The impact on headline inflation is expected to be only small



Source: GenAM calculations

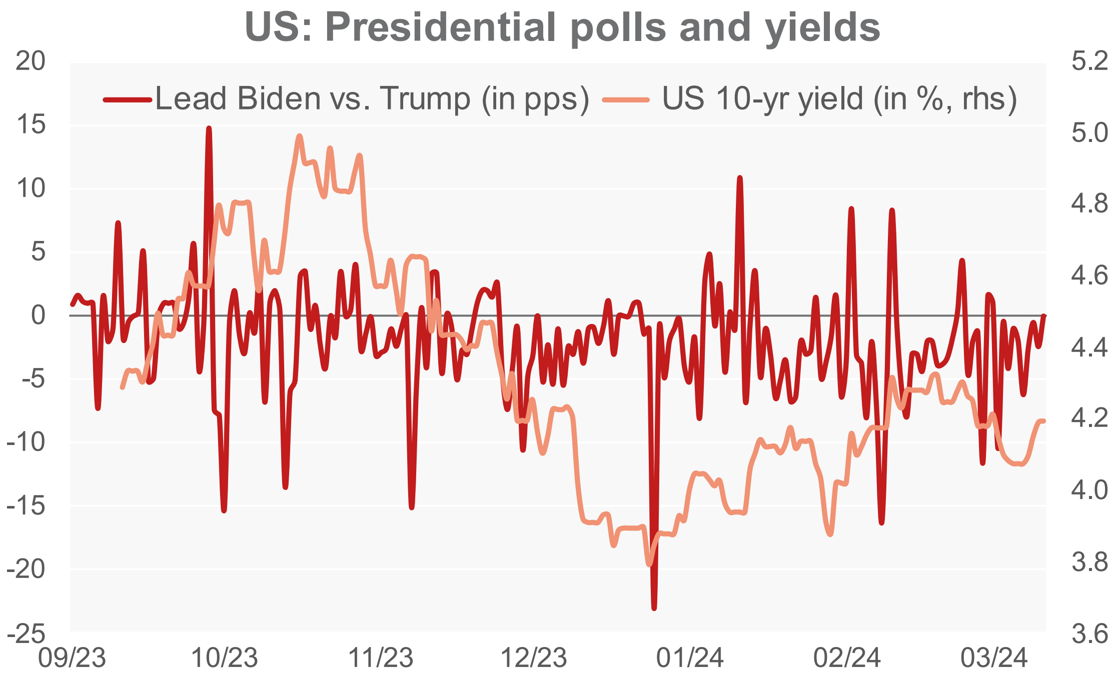


Source: Datastream, GenAM

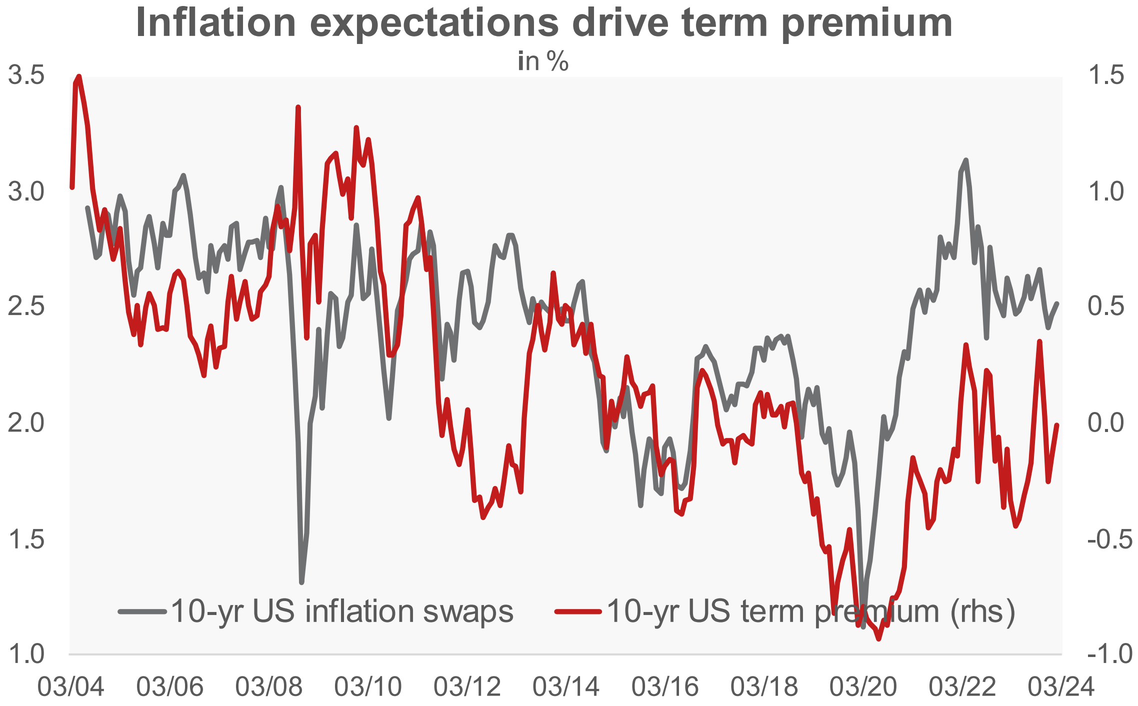
- The **share of the EA/US goods trade surplus in EA GDP was 0.95% in 2023**. However, in services trade the EA exhibits a deficit which stood at -0.7% in 2021 (latest available). When services and investment are taken into account, the US remains the EU's largest trading partner by far, regarding goods it is China since 2020.
- The model result (60% tariff + retaliation + recycling of revenues) brings a **negative GDP impact from 2026 onwards,** extending to 0.7 pp in the medium term (2028). The **export-oriented economies will suffer most**, especially Germany.
- On balance, tariffs are set to have only a minor impact on inflation in this scenario. This and less growth gives the **ECB leeway to cut policy rates** by about 50 bps.

Gov. Bonds: Yield curve steepening and higher Treasury yields (relative to base case)

A Republican sweep may even lead to US yields trending sideways from current levels



Source: Bloomberg, YouGov, GenAM

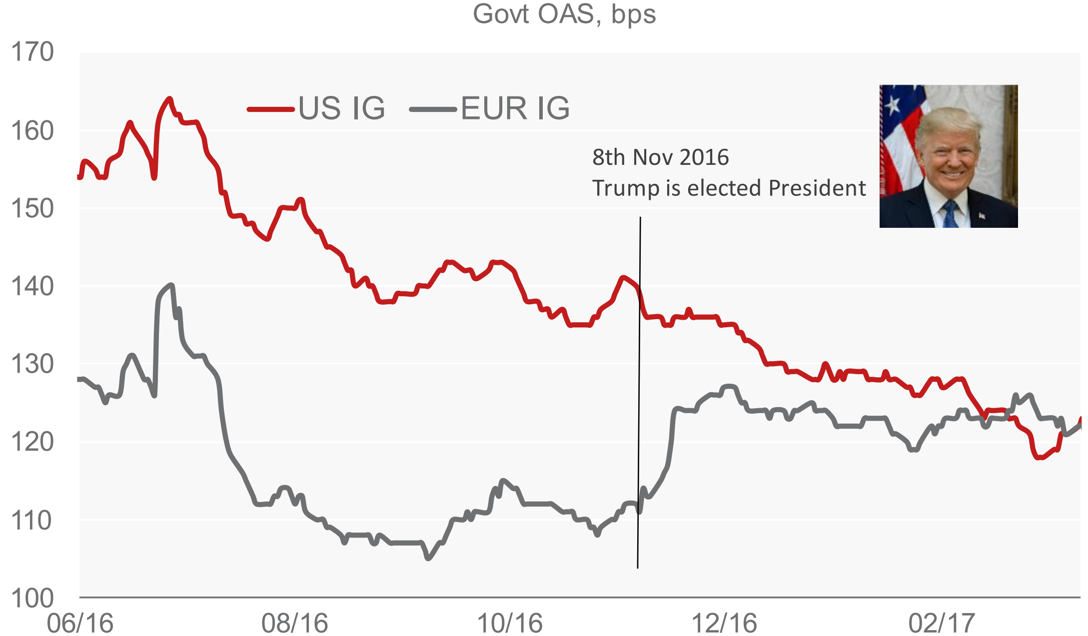


- In the case of a divided Congress the higher inflation rate is partially balanced by lower growth limiting the effect on US yields. Due to rising inflation expectations and a vigilant Fed, **we still expect on balance somewhat higher yields (compared to the base scenario)**.
- A Republican majority in Congress allows higher budget deficits to offset the growth-dampening effect of the tariff increase. Hence, the yield increase is stronger in this scenario. A **noticeable decline in yields from the current level is not to be expected in this case**.
- Higher inflation and rising pressure on the Fed (and subordination of the CB) trigger a higher term premium and lead to a **steeper yield curve**.
- In both scenarios the **transatlantic yield spread** is seen to widen relative to the base scenario.

Credit: Trump 2.0 to be likely favourable

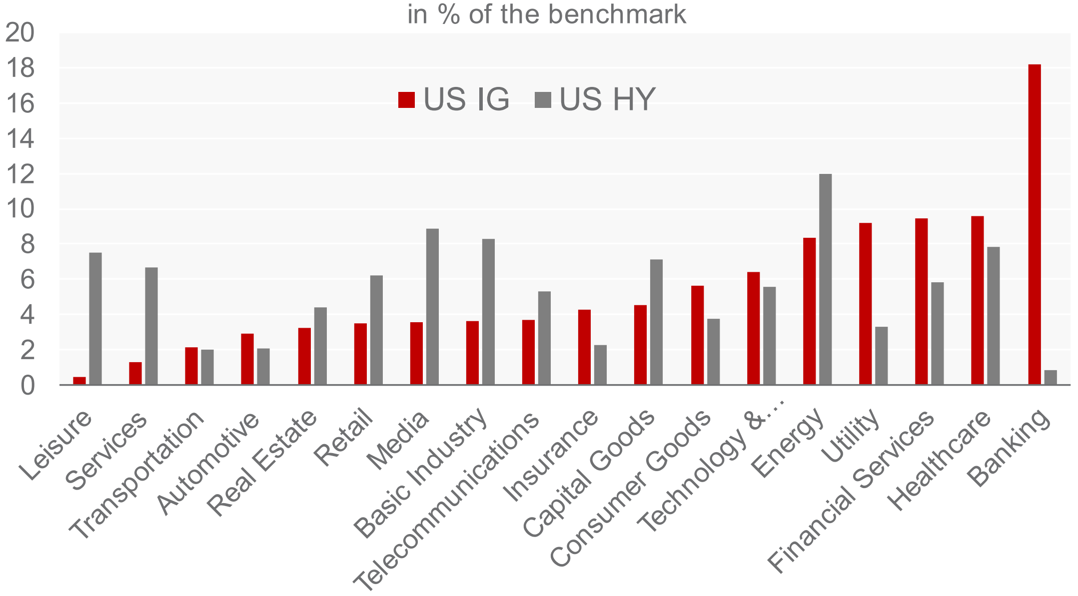
Positive US HY (more domestic) over US IG (more global) and US over Europe (more global)

Euro credit underperformed into the Trump 1.0 election



Source: Bloomberg, BofAML indices, GIAM

US IG vs HY sector composition



Source: Bloomberg, BofAML indices, GenAM

- Seasonality is the same as for non-election years until September-October when volatility is higher than normal, and then November-December when it's lower
- **Trade = tariffs likely higher under both D (+) and R (++++) . Favour US HY (more domestic) over US IG (more global) and US over Europe (most global)**
- Regulation: pure US issue but about Banks (winners if R sweep on deregulation) and Healthcare (losers on price reform in either R or D sweep, but fine if it's a split).
- Fiscal: biggest issue **if R-sweep** = could have both fiscal and monetary stimulus at the same time. More reflationary. Could be the 2nd wave of inflation that the market is concerned about. **Possibly risk-on for equities, but no so for credit** (higher yields; HY less exposed than IG).

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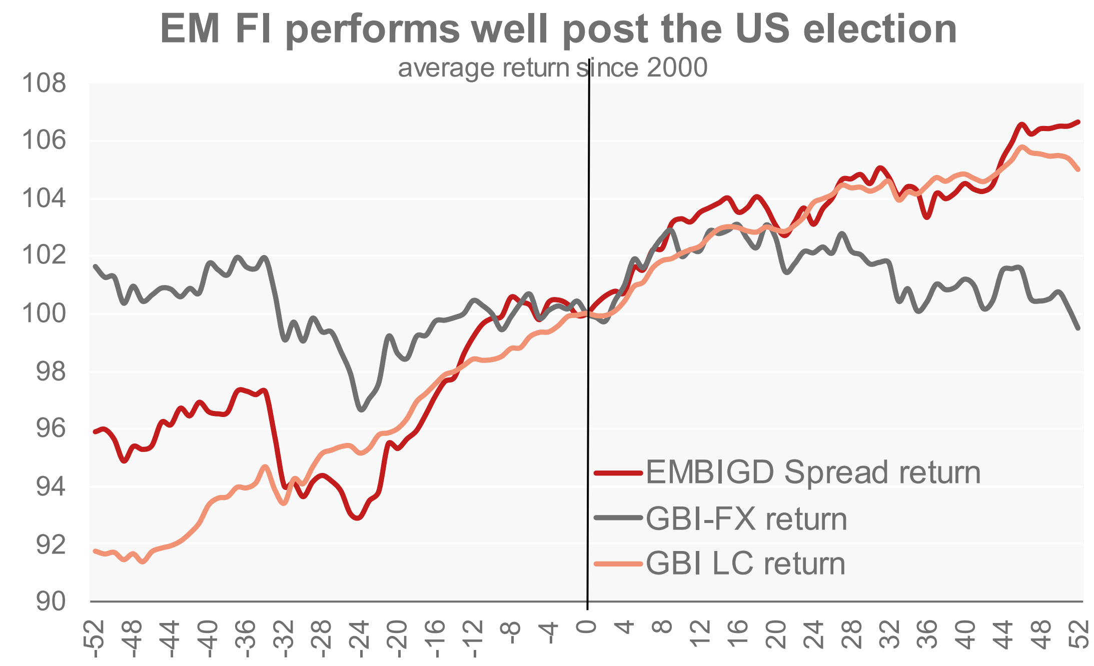
EM: touched but not sunk

More regionalisation to favour Mexico and hurt CEE/ASEAN



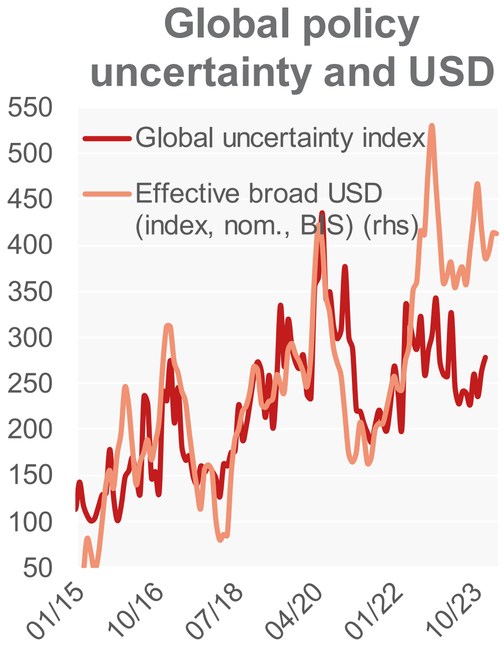
Source: Bloomberg, GIAM

- **US elections tend to benefit to EM fixed income on average:** in 2016, it had a poor performance initially. EM FX high-yielders were the most impacted (more volatility). However, EM external/local debt fully recovered in 2017 despite higher US rates. EM began to suffer in 2017 as macro implications became apparent.
- **Tariffs to lead to more regionalisation**: since 2016, EM exports to US (ex-China) have become more important. **Winners**: Mexico thanks reshoring. Re-localisation from China to Vietnam and Thailand. **Losers**: CEE and ASEAN (Korea) given their integration into current supply chains.
- **EM debt**: Favour IG over HY affected by higher vol. and carry trades unwinding. Favour external over local as the market will reprice rate cut expectations.
- **EM FX to trade sideways**: USD is stronger in REER terms vs EM than in 2016. China-proxy ZAR to lose and MXN vulnerable to USMCA changes.

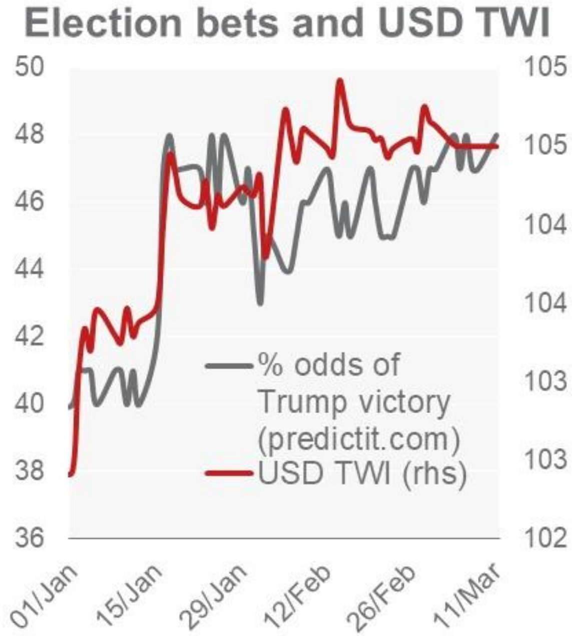
FX impact: Trump victory would benefit the USD

Uncertainties, the impact of tariffs and capital inflows would support the greenback

*based on OECD estimate for country's import content in overall exports
Source: Datastream, GenAM



Source: www.policyuncertainty.com, Datastream, GenAM

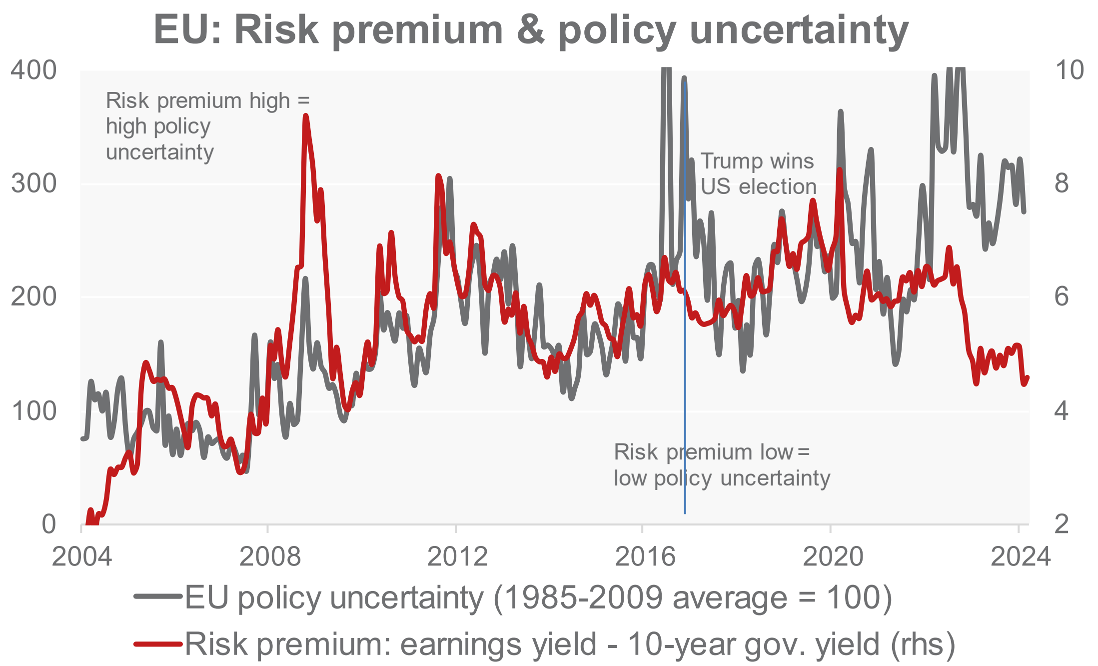


Source: predictit.com, Bloomberg, Datastream, GenAM

- A **Trump victory** would **prove USD bullish**, partially offsetting the depreciation forces from other drivers (see FX section):
  - **Global policy uncertainties** (tariffs, policy responses) and rising political tension to trigger safe haven bids on the USD
  - **Trump victory, split Congress**: US tariffs a USD positive vs. base case (higher inflation, more hawkish Fed); FDI inflows to increase amid US protectionism, curbing baes case of mild EUR/USD ascent
  - **Trump victory + ‘red wave’:** tax cuts to foster capital inflows even further; EUR/USD may even fall vs current readings (vs. ascent in base case)
- **FX most adversely impacted**: **CNY** (punitive tariffs/ trade war); **CHF, EUR to suffer; MXN, CAD exposed** but mind possible preferential treatment.

Equities: Trump + split Congress would support a cyclical tilt on sectors

Exporters' risk premium at risk. Hedges: India, Vietnam, Mexico, Switzerland, Japan and Defence



Source: Datastream, GenAM calculations

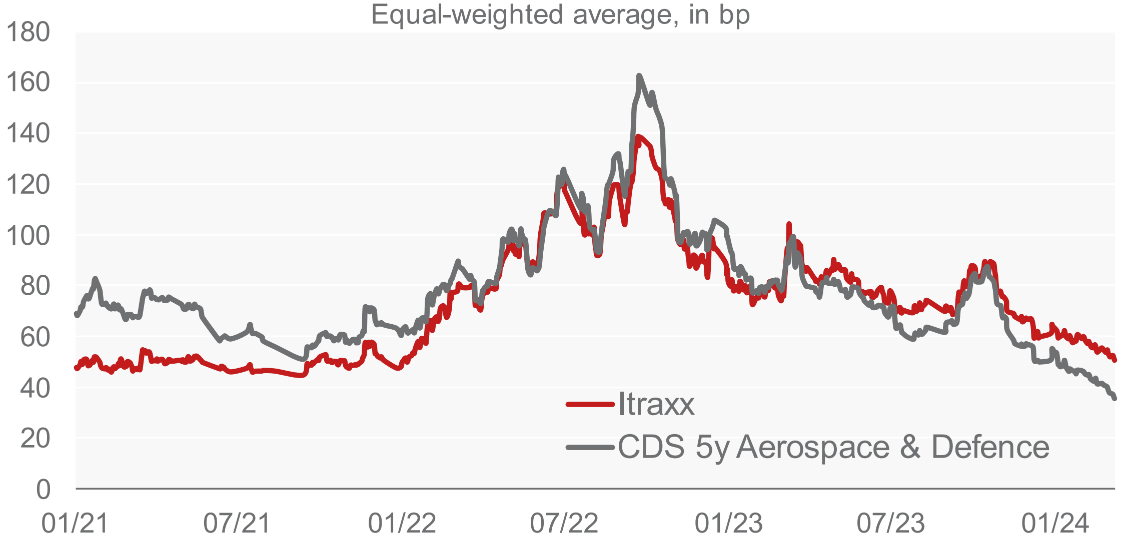
- In an election year, equities tend to be slightly positive, although just before November we could see a **spike in volatility** and range-bounding markets. However, **after the election, markets tend to rally** (+5-7% with cyclicals outperforming) while volatility decreases.
- If **Trump wins** with a split Congress, we should see a **mildly positive sector tilt towards cyclicals-Value** (higher yields) plus **financials and energy** (deregulation) versus a base case scenario. Sentiment on the renewables/green energy/ESG space could take a hit. The chances of **higher tariffs plus a stronger TW USD** could exacerbate the **risk premium for Europe and other exporters such as EM, Korea and China**, among others. In this respect, **hedges are represented by India, Vietnam, Mexico, Switzerland and Japan**. We also add the **defence** sector. We should bear in mind that the valuation gap between the EU index and the US is already extreme, so that the negative reaction for Europe should be negative but limited overall. An increase in political uncertainty for China should be seen in the context of very low valuations for MSCI China. In addition, the **Chinese government could intervene more boldly to support the economy**.

ESG Trump vs Biden – Defence is the new attack

It isn't enough to talk about peace. One must believe in it.
And it isn't enough to believe in it. One must work at it.
*— **Eleanor Roosevelt** (1884-1962)*

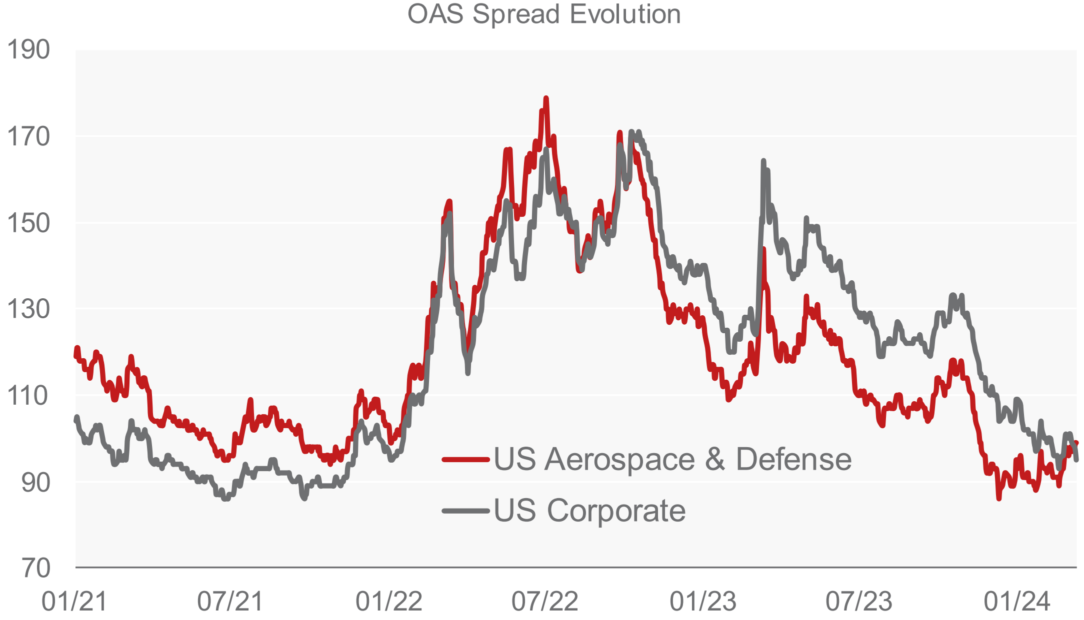
Most of the pushback has already happened in the US – further regionalisation of ESG trends expected

European defence sector CDS are now trading at a premium versus the benchmark



Source: Bloomberg, GenAM, average of Airbus, Leonardo, Safran and Thales 5Y CDS

The re-rating of the US aerospace & defence sector



Source: BofAML indices, GenAM

- In the US single materiality (financial impact only) is the norm (regulation from the Dept of Labor for instance)
- Under Trump 2.0 likely **higher geopolitical tensions will imply higher defence spending – those should be supported by ESG regulations globally**
- **IRA related large tax credit should remain in place even if Trump is elected** (for instance Texas is very big on wind).
- Under Trump ESG would be attacked but a large part of it has already happened ➔ **further fragmentation of ESG standards across US states**
  - ➢ Some of the Democrat states have implemented policies designed to enforce fossil fuel divestment (CalPERS and CalSTRS in California)
  - ➢ On the Rep. side states like Texas that now prevents its public pension funds from investing into asset managers "boycotting" the oil industry.

GENERALI ASSET MANAGEMENT

APPENDIX – IMPRINT

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