

## No. 180 The Economic Consequences of Mr. Trump\*

Politicians across Europe are still reeling at the shock election of Donald Trump as US President. That is understandable. They nevertheless need to snap out of it and start thinking seriously about how Trump's triumph will impact Europe both economically and politically. The question on everybody's lips is: how much of his election campaign rhetoric will Trump actually attempt to turn into economic policy and how should Europe react? Although his policy proposals to date have been hazy on detail, a fairly clear picture of Trump's position has nevertheless emerged in four key areas.

**Trade policy** will be more restrictive. Trump will put a stop to the transpacific trade agreement TPP, terminate the present North American Free Trade Agreement (NAFTA) with Mexico and Canada and renegotiate it. Tariffs will be levied on imports from Mexico, which will negatively impact many US and German companies that produce in Mexico for the US market, or source intermediate products in Mexico. The depreciation of the peso that has already occurred will partly offset the new tariffs. Ultimately, however, it is Mexican workers who will suffer since their living standards will fall due to the peso's depreciation. As far as TTIP is concerned, Trump has not made any clear statements to date; but he is highly unlikely to press ahead with negotiations. For Europe this means that the growth in trade with the USA promised by the agreement will not materialise. But this does not mean that existing trade flows have to dry up. On the contrary, they may even increase thanks to Trump's plans in fiscal and tax policy.

In this area the new President-elect has announced plans to make **major cuts to income tax and taxes on corporate profits**, and to boost investment in public infrastructure at the same time. This, in turn, would drastically increase the US budget deficit. There is a real danger that such a policy would shatter investors' confidence in the solidity of US public finances. As far as infrastructure investments are concerned, the danger is relatively low, as such temporary expenditure contributes to growth and will generate future tax revenues. But the tax reductions touted by Trump will be longer-lasting and will certainly be heavily used to finance consumption or higher savings. Both measures should boost economic growth in the USA - at least temporarily - which will fuel inflation and push up interest rates.

On a brighter note, this would give a further boost to Europe's exports to the USA, which are already dynamic. The Trump government would certainly reject the idea of any increase in the US trade deficit with Europe; but that could only be avoided if expansive fiscal policy was accompanied by an increase in import tariffs. To achieve this, however, the USA would have to leave the World Trade Organisation (WTO). Such a radical step would close off export markets to US companies, as well as destroying millions of jobs in the USA. Surely even Trump would not go that far. A problematic side-effect of US fiscal expansion is that it may bring the low-interest phase in Europe to an end sooner than expected. Those EU states that still have high debts, especially in southern Europe, could be in serious trouble if interest rates were to rise. Banks holding large quantities of government bonds, or that have granted long-term mortgages at very low rates would also find themselves in trouble. And that could include German lenders.

A third major policy turnaround can be expected from Trump in the field of **energy and climate policy**. The president-elect wants the USA to withdraw from the fight against global warming and to focus more on its own extraction of fossil fuels, especially coal and shale gas. Europe can only react to this with pleas for reason and by threatening to divert its own efforts to cut CO<sub>2</sub> emissions into adjustments to climate change.

Another key shift can be seen in Trump's vision of the US role in **international security policy**. Trump wants the USA to remain a member of NATO, but would like Europeans to foot a larger share of the defense bill. At the same time, Trump has expressed his desire to cooperate more closely with Russia's President Putin. This is a clear signal to Europe that it needs to become more independent in military terms. To achieve this, the EU will need not only the French, but also the British nuclear arsenal; and Germany will have to spend more on weapons too. The need to create an effective

European defense union is more pressing than ever. Against this background, the EU should be lenient with Britain in the forthcoming Brexit negotiations.

Shocking as it may be, Trump's victory is a wake-up call for Europeans, who need to set aside their internal squabbles and focus on uniting to represent their interests more effectively.

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