



To the point!

Cross-Asset- and Strategy-Research

A toxic mix: Trump, debt and inflation

Moritz Kraemer -- Chief Economist

LBBWResearch@LBBW.de

June 28, 2024

Trump's economic plans could threaten global financial stability

This month, I had the pleasure of attending the 25th-anniversary celebrations of LBBW in New York. It was not only a festive occasion, but also an opportunity to engage with local U.S. economists. Regardless of where our conversations began, they invariably ended on the topic of the upcoming presidential election. Or, more precisely, its potential consequences. But above all: what a second Donald Trump presidency could mean. A topic that caused worried frowns.

When examining the economic policy announcements of candidate Trump, the package as a whole is clearly inflationary. Trump's often impromptu campaign speeches consistently highlight three measures: raising import tariffs, cutting taxes, and the mass deportation of undocumented immigrants – a recipe for driving up prices.

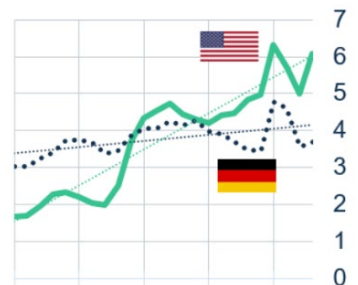
Is the independence of the Federal Reserve at risk?

Naturally, the Federal Reserve (Fed) would have to counteract the inflationary impact of those measures, should they be enacted. In such a scenario, the anticipated interest rate cuts next year would surely be off the table. Even a hike in the policy rate could be envisioned. A President Trump would, of course, take this personally (in his view, everything revolves around him). We remember his first term, during which he regularly criticized Fed Chair Jay Powell for allegedly keeping interest rates too high. Even though he himself had nominated him for the position. In Trump's mind Powell displayed a lack of loyalty – or sycophancy.

A president's persistent nitpicking at an independent central bank is damaging enough. However, a Trump 2.0 presidency could go beyond mere grumbling from the Oval Office. Powell's

Trump's plans are inflationary

Federal government debt as a multiple of revenues (with trend line)



2000 2005 2010 2015 2020
Source: USTD, OMB, Deutsche Bundesbank, LSEG, LBBW Research

Debt Definition "held by the public", excluding bonds held by public social security systems.

term ends in early 2026, and the White House has the right to nominate his successor. Some of the rumored names for potential successors give us economists goosebumps – and not in a good way.

While the risk that Trumpists could completely infiltrate the Fed seems moderate – given the institution's federal structure and the fact that the Fed Chair doesn't make decisions alone – the mere discussion of whether a U.S. government could politically undermine the central bank is alarming in itself.

The main problem remains the high debt

However, the greater danger would loom from the toxic combination of soaring national debt on the one hand and a Fed that needs to keep interest rates higher to combat inflation on the other. In this situation, the U.S. could quickly slip into what economists call "fiscal dominance": the central bank would, in practice, no longer be free in its decision-making because of the overwhelming national debt. Raising interest rates could then lead to an unsustainable interest burden for the state, ultimately resulting in state bankruptcy. And we're not talking about Greece here! The market for U.S. Treasury bonds is absolutely essential to the functioning of the global financial system. A loss of confidence here could lead to the mother of all financial crises.

Consolidating the U.S. federal budget should, therefore, be a top priority! Unfortunately, neither the Democrats nor the Trumpists have grasped the nettle of this pressing priority. Neither offers a convincing plan of consolidating public finances. Predicting the "point of no return" is difficult, but given Trump's economic policy plans, that tipping point could come sooner than previously feared under his leadership.

I wish I had brought back from New York more positive news.

Disclaimer:

This publication is addressed exclusively to recipients in the EU, Switzerland, Liechtenstein and the United Kingdom. This report is not being distributed by LBBW to any person in the United States and LBBW does not intend to solicit any person in the United States.

LBBW is under the supervision of the European Central Bank (ECB), Sonnemannstraße 22, 60314 Frankfurt/Main (Germany) and the German Federal Financial Supervisory Authority (BaFin), Graurheindorfer Str. 108, 53117 Bonn (Germany) / Marie-Curie-Str. 24-28, 60439 Frankfurt/Main (Germany).

This publication is based on generally available sources which we are not able to verify but which we believe to be reliable. Nevertheless, we assume no liability for the accuracy and completeness of this publication. It conveys our non-binding opinion of the market and the products at the time of the editorial deadline, irrespective of any own holdings in these products. This publication does not replace individual advice. It serves only for informational purposes and should not be seen as an offer or request for a purchase or sale. For additional, more timely information on concrete investment options and for individual investment advice, please contact your investment advisor.

We retain the right to change the opinions expressed herein at any time and without prior notice. Moreover, we retain the right not to update this information or to stop such updates entirely without prior notice.

Past performance, simulations and forecasts shown or described in this publication do not constitute a reliable indicator of future performance.

The acceptance of provided research services by a securities services company can qualify as a benefit in supervisory law terms. In these cases LBBW assumes that the benefit is intended to improve the quality of the relevant service for the customer of the benefit recipient.

Additional Disclaimer for recipients in the United Kingdom: Authorised and regulated by the European Central Bank (ECB), Sonnemannstraße 22, 60314 Frankfurt/Main (Germany) and the German Federal Financial Supervisory Authority (BaFin), Graurheindorfer Str. 108, 53117 Bonn (Germany) / Marie-Curie-Str. 24-28, 60439 Frankfurt/Main (Germany). Deemed authorised by the Prudential Regulation Authority. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details of the Temporary Permissions Regime, which allows EEA-based firms to operate in the UK for a limited period while seeking full authorisation, are available on the Financial Conduct Authority's website.

The mere
discussion of
independence
is alarming

No candidate
has a
convincing
budget plan
