Investment Institute Macroeconomics

Remember “Trumpnomics”?

- Consumer confidence is surprisingly low in the US. This does not bode well for Biden’s re-election bid. We look into what could be the trade policy of another Trump presidency.
- Christine Lagarde was quite straightforward about anchoring June as the likeliest start for the rate cuts.

Donald Trump’s victorious Super Tuesday, combined with so far favourable decisions by the Supreme Court, make it now highly likely that the November duel will be a re-run of 2020 at a time when, in the general polls, Joe Biden is slightly trailing his Republican opponent. The current President used his State of the Union speech to highlight the country’s strong economic performance. What is however striking is that consumer confidence is now significantly lower than what a so far successful model combining the unemployment rate, inflation and equity prices suggests. It seems the US extreme political polarization is colouring citizens’ assessment of the state of the economy, but Biden cannot count of Democrats’ enthusiasm about their economic conditions. Indeed, even they assess them as slightly below their long-term average. Looking back at all incumbent’s re-election bids since 1972, the level of consumer confidence at this stage of the campaign is lower than those seen in successful bids.

Now, elections are not necessarily won on the economy. Donald Trump’s lost his own re-election bid in 2020 despite a high level of consumer confidence. We think it is however time to start looking hard at what a possible second Trump mandate could mean. We focus on a recent contribution of Peter Navarro, Donald Trump’s former international trade envoy. He unveiled in detail his plan for the US to threaten – and potentially ultimately enforce – additional custom levies to systematically bring the US tariffs on par with the tariffs imposed by the US clients. Some of these elements have already found their way into Donald Trump’s campaign. This would hurt geopolitical allies of the US such as the EU, as well as an emerging power such as India, on top of China, the explicit key target there.

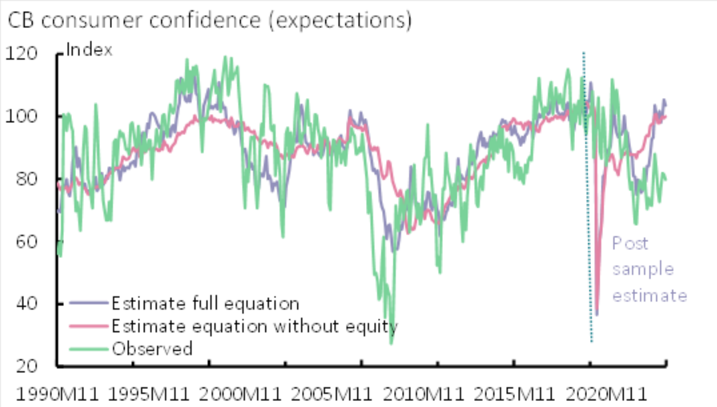
Separately, we think Christine Lagarde hinted quite clearly as June as the likeliest moment for the first rate cut. The ECB still needs more clarity on wage growth in particular, but the more dovish than expected new batch of forecasts signals a clear readiness not to waste too much time before starting to remove some of the current policy restriction.

Is it still "the economy, stupid"?

We have been writing a lot lately on the extraordinary resilience of the US economy, but there is one striking aspect of it which we have not commented so far: the fact that ordinary Americans do not seem to see it. Indeed, **even before the monthly dip in the consumer confidence observed for February, its level since last summer has not been in sync with the stellar GDP prints**, which is all the more surprising since consumer spending has been the main engine of such performance. **Americans are keen to spend their money, but at the same time they remain quite grumpy about their economic prospects.**

To quantify this, **we estimate a very simple model** in which consumer expectations, taken from the Conference Board survey, are explained by the unemployment rate, inflation and the year-on-year change in equity prices (we take the S&P500), all lagged by one month. We tried other variables - the interest rate, both Fed Funds and mortgage rates, as well as wages, both in nominal and real terms- but their impact on consumer confidence came out as insignificant. With the three variables we retained we could explain more than 50% of the variance of consumer confidence between 1990 and 2019. When we use the model beyond the estimation sample, it exaggerates the decline in 2020 - which makes sense since it cannot fully take into account the effect of the massive fiscal support granted during the pandemic - but **it also projects for the more recent period a much higher level of confidence than what has been observed** (see Exhibit 1). A gap of more than 20 points appears for February 2024, the latest point we have.

Exhibit 1 – US confidence lower than it "should" be



Source: Conference Board and AXA IM Research, March 2024

An easy explanation would be that our model gives too much weight to equity prices, which have soared further recently, which may affect only a small proportion of households. To control for this, we have estimated an alternative model in which we only took the unemployment rate and inflation on board. Its retrospective performance is weaker, but it still fails to get the recent grumpy mood. When controlling for volatility, **actual consumer confidence is 0.7 standard deviation *below* its long-term average, when "objectively" it should be some 0.7 standard deviation *above***.

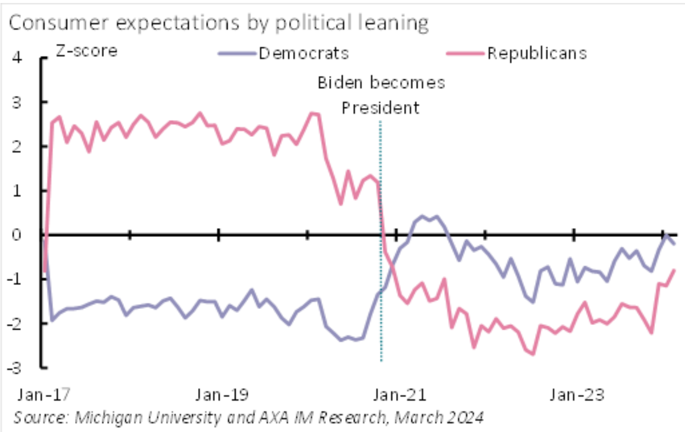
From a purely economic point of view, this point may not be very significant. Academic literature overwhelmingly concludes to a weak impact of pure "mood" on actual spending. Such grumpiness would not necessarily make us more negative on the outlook for the US economy. We think consumption will duly decelerate gradually in 2024, as income growth softens and savings rates rise from recent post-pandemic lows – all a natural consequence of the monetary tightening finally making its way through business decisions, triggering a slowdown in job creation. From this point of view, the downward revision of the recent months' payroll data lends some support to the idea that a slowdown – albeit a very controlled one – is now on the cards. Yet, **with the presidential elections looming, this "unexplained grumpiness" of consumers emerging even before the economy takes a gear down is of course politically relevant**.

Classically, causality goes from objective economic conditions to citizens' confidence and then support – or distrust – for the incumbent President. The dominance of economics in the design of campaigns was nicely encapsulated in the famous "*it's the economy stupid*" of Bill Clinton's campaign in 1992. Yet, with such a divorce between "objective" and "subjective" conditions, we are left with two hypotheses. In the first – the reassuring one for Biden – it is only a matter of time. Americans are still reeling from the recent inflation shock (they may care more about the level of prices than about their change) and with a bit of patience they will see the reality of the strong economy – assuming it remains so by the time of the election. The other hypothesis would be more concerning for Biden. **We may be in a reverse causality configuration now, with purely political sentiment about the generic direction of the country colouring the appreciation of economic conditions**. If the latter dominates, there may not be any amount of strong employment and wage prints which could alter citizens' perceptions. Consumption is driven by real income, not by "sentiment", but sentiment still matters in the electoral realms.

We have our doubts on the "patient" approach, at least on the idea that consumer confidence is still affected by the past inflation surge. Indeed, the Conference Board survey never reflected a significant and lasting uptick in consumers' inflation expectations (a separate question in the survey). If the respondents are consistent, their belief in anchored inflation should keep them cheerful on their prospects for real income (remember, we look at the "forward-looking" component of consumer confidence.

Conversely, we find support for the "reverse causality" approach by looking at another consumer confidence survey – the one conducted by Michigan University – for which we have a breakdown by political leanings on a monthly basis since 2017. The Conference Board one is usually considered as the most relevant because its sample is massive, relative to the Michigan survey and its 600 individuals, but we checked that on the forward-looking component the correlation between the two is very high. The message from Exhibit 2 is striking: **under the Trump administration, expectations of Republican-leaning consumers stood about 2 standard deviations *above* their long-term average, while expectations of their Democrat-leaning counterparts stood about 2 standard *deviations* below. The lines crossed exactly when Joe Biden came to power**, and since then Democrats have always felt perkier than Republicans. **A key difference though is that under Biden, Democrat-leaning respondents have never felt as good Republicans under Trump, their expectations level staying at or slightly below its long-term average**. If even Democrats are not particularly enthused by the results of Joe Biden's policies, he has reasons to worry. Symmetrically, Donald Trump can count on the fact that his natural followers have good memories – at least from an economic point of view – of his last tenure. There were quite a few articles recently in the US press about "Trump nostalgia". We provided here some statistical underpinnings for it. **Since elections are no longer necessarily won on the centre but result from the difference in the mobilisation capacity of each party's supporters, this gap between "unenthusiastic Democrats" and "bulled-up" Republicans may matter.**

Exhibit 2 – Politics heavily colour views on the economy



It is of course very early in the race to try to detect in quantitative data indications for the election outcome**. An old model from the early 1980s – which seems to have left a clear imprint on many US pundits – suggest that American voters make up their mind towards the end of the spring of the electoral year** and do not change it much afterwards. The paper by Lewis-Beck and Rice more precisely suggested that the June Gallup poll on the incumbent President popularity was a strong predictor of re-election chances by November, and that the October poll provided only small additional information. These were the wild days of econometric analysis though, and your humble servant would never dare to present a model estimated on such a tiny number of observations (only 6 Presidents had been re-elected since the Gallup poll was created in 1938 by the time they wrote their paper).

In a more satisfying 2007 CEPR paper, Hardouvelis and Thomakos had the great idea to use a much larger sample of European elections on top of American ones to test the predictive content of consumer confidence on electoral outcomes. They produced two very interesting results. One, that in general consumer confidence tends to increase during an electoral year, and second that the *initial* level of confidence – i.e., well before the vote – mattered a lot. In other words, **an incumbent faces a low re-election probability if consumer confidence is low a year before the vote even if it improves in the run-up**. These findings fit the European and the US data, and as such that would be a source of concern for Joe Biden.

We are not going to take the risk of estimating a model here – the number of re-elections of incumbents has not dramatically increased since 1982 – but we think descriptive statistics can be helpful here. In Exhibit 3, we have reported the level of consumer expectations (using the Conference Board data) in February, June and October of each year an incumbent President was seeking re-election (we excluded the case of Gerald Ford in 1976 since he had not been directly elected in 1972 but served as replacement after Nixon's resignation). **The lowest level hit by consumer confidence (expectation component) in February of a year an incumbent won was 88.4 (Obama in 2012). The February 2024 level stood at only 79.8.** This is only slightly higher than what had prevailed the year Jimmy Carter failed to win re-election in 1980. To add to the concerns over Biden's bid, the table fits with Hardouvelis and Thomakos' findings that even if consumer confidence eventually improves (that was the case for Carter and Bush senior) re-election can be missed.

Exhibit 3 – Some historical perspective

Consumer confidence and US presidential reelection bids

Incumbent won			Incumbent lost		
Nixon 72	*Feb*	*110*	Carter 80	*Feb*	*74.1*
	June	*107.5*		*June*	*62.3*
	October	*113.3*		*October*	*99.6*
Reagan 84	*Feb*	*114.7*	Bush 92	*Feb*	*63.5*
	June	*110.6*		*June*	*95.9*
	October	*102.0*		*October*	*70.7*
Clinton 96	*Feb*	*89.5*	Trump 20	*Feb*	*108.1*
	June	*90.3*		*June*	*106.1*
	October	*95.7*		*October*	*98.2*
Bush 04	*Feb*	*91.9*			
	June	*100.8*			
	October	*92.2*			
Obama 12	*Feb*	*88.4*			
	June	*73.4*			
	October	*84.0*			

February 2024 level: 79.8

Source: Conference Board, AXA IM Research, March 2024

What can make the Democrats hopeful is the specific personal equation of Donald Trump. Consumer confidence at the start of the year of his re-election bid in 2020 was higher than what three of his successful predecessors had to deal with (Clinton, Obama, and George Bush Junior) and on par with what Nixon and Reagan enjoyed. He still lost. This suggests **that Biden's best chance to defeat Trump again lies not so much in touting his – objectively good – economic record, but by simply making it plain that "he is not Trump". The election may not be won on the economy.**

This gets us to a paradox. The 2024 election may well end up in a very personal fight, with a focus on social issues, while the economic platforms of the two candidates should in our view attract a lot of attention. They are consistent, largely divergent, and consequential. **Culture wars may decide the fate of the election, but the rest of the world will have to deal with very tangible consequences of stark US economic choices**.

A trip in a Trumpist economist mind

We immersed ourselves in the latest edition of the "Mandate for Leadership" published by the Heritage Foundation. Before every election year, this firmly Republican Think Tank produces a very detailed "Vade Mecum" for the next Conservative administration (the Heritage foundation uses "conservative" more often than Republican in its production). While this Think Tank had initially been quite suspicious about Donald Trump in 2016, it is now strongly aligned with his re-election bid. It would take much more than one issue of Macrocast to discuss all the policy themes explored in the sprawling document, and we chose to focus on the bit on international trade, written by Peter Navarro, since it is the aspect of Trumpnomics which has probably the most immediate impact on the rest of the world.

We think it would be dangerous not to take the views of the technocrats around Donald Trump seriously. Peter Navarro – who served as US trade envoy under Trump for the entirety of his mandate – did not earn a PhD in economics at Harvard by chance. He "knows his stuff" and he is consistent. Bilateral trade deficits are his point of entry in the issue. He draws a connection between the fact that most trade partners of the US maintain higher customs duties than the US and makes this responsible for the US chronic deficit. **Navarro resurrects the US Reciprocal Trade Act (USRTA) which Donald Trump put on the table in 2019**, under which the US would bring the tariff on products imported from a given country to the same level faced by American products on this market. Note that this would directly contravene the World Trade Organization (WTO)'s Most Favoured Nation principle according to which tariffs must in principle be the same across all import origins (outside free trade agreements or exceptions on imports from less developed nations). Navarro makes it plain that the USRTA would be more a way to gain leverage in negotiations with foreign countries to convince them to drop their tariffs, but he uses the World Bank SMART model to argue that it would still be a credible threat because setting up reciprocal tariffs would reduce the US deficit by roughly the same magnitude as a convergence of foreign tariffs to the US level. Among the targets of this approach, Navarro explicitly mentions China, India, and the EU. The EU's tariffs are actually not that much higher on average than the US ones, but it would still be a target because of the size of the US bilateral deficit with this region.

Where Navarro's analysis is highly disputable, it is in his convenient ignorance of the side-effects of such reciprocal tariffs. Indeed, while they might reduce the US trade deficit, they would also end up being paid by US consumers via higher inflation. Indeed, according to Navarro's computations, the average tariff differential on the 67% of products on which foreign countries apply a higher levy than the US stands at 12.3%. This would be consistent with an average rise of the US tariffs, if USRTA was enforced, of 8.3 percentage point. According to the WTO data, the *current* weighed average of US tariff stood at 3.4% in 2022. The resulting level would not be very different from the 10% "universal baseline tariff" proposed by Donald Trump in August 2023. **Given the import content of US consumption, such tripling of customs duties could lift US consumer prices by nearly 1%.**

Another flaw in our view is that in his computation, the total impact of reciprocal tariffs would reduce the deficit by 10%. This quite simply suggests that 90% of the US trade deficit cannot be explained by tariff differentials. Navarro then moves his gaze to non-tariff barriers, but at no point in his discussion he mentions the possibility that the deficit simply reflects an excessive preference for consumption in the US.

Yet, whatever the limits, **we can easily see how such a proposal, in all its apparent simplicity and fairness, may be a vote winner in November.** When inflation was nicely moving within a 1 to 2% range, a 1% price shock was probably politically unacceptable. Now that consumers have had to deal with 4%+ inflation, it might still be politically tempting to enforce higher tariffs on the hope that their impact on prices will be drowned in the general noise. This makes us think that this threat should be taken seriously by all export-driven countries in the world, and even strategic allies of the US like the EU would not be immune.

Indeed, another striking aspect of Navarro's exposé is that he never links trade relations with the overall international policy of the US, apart from repeatedly denouncing China's willingness to "dominate the world". Allies of the United States do not seem to get any favourable treatment, nor India, an ostensibly non-aligned country which should be part of any strategy to contain China in Asia. It may be that many around Donald Trump believe that the US current allies simply have to no other choice but to accept Washington's views on trade, even if they may be harbouring doubts as to the solidity of the US promise of military support in case of aggression. There may not be much room for a quid pro quo there.

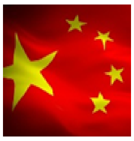
ECB: pretty explicit about the timeline

While we suspect politics – and geopolitics - will again play a major role in the macro outlook in the years ahead, we still need to keep a close eye on "bread and butter" issues in the more traditional realm of monetary policy.

We thought that, although she would be open about the fact that the debate about rate cuts had started within the Governing Council, Christine Lagarde last week would remain vague about the timeline. She was more straightforward than we expected in her answers to the first questions: the European Central Bank (ECB) is getting "*more confident*" about disinflation, although "n*ot sufficiently confident*" to make decisions right now, but they "<u>*will know much more about it in June*</u>" which we think is **quite a straightforward manner to anchor expectations around a rate cut at the June meeting**, which has been our call for a long time and is now the market's central view.

Indeed, by then the result of the crucial wage negotiations data for Q1 will be available. Q4 wage data pointed to some deceleration but it was faint, and services prices remained on the strong side, which is the main reason they are not cutting right now. Yet, their overall conviction disinflation will continue is reflected in the slight downward revision in their inflation forecasts not just for 2024 but also for 2025 and 2026, which is on the dovish side relative to consensus expectations. The time at which headline inflation is projected to hit the ECB 2% inflation target is unchanged from December (H2 2025), justifying the *current* unchanged, broadly neutral policy stance. However, instead of hitting just 2% as pencilled in December, it is now due to hit 1.9%yoy in both Q3 and Q4 2025, and even reach 1.8% in Q1 2026, before edging up to 1.9% in the remainder of 2026 (unchanged from December). Falling, even ever so slightly, below the target matters in our view.

Also of note, in response to a question **she made it plain that the ECB would not necessarily wait for the Federal Reserve (Fed) before cutting if the situation of the Euro area warrants it**. This matters since some members of the Governing Council had publicly opined this would be difficult. Given the doubts in the market emerging on a cut by the Fed by June, this is an important message. This is why we were quite surprised by the re-appreciation of the euro exchange rate after the press conference.

Country/Region	What we focused on last week	What we will focus on in next weeks
	• Super Tuesday – 15 State Primaries: as expected with Trump & Biden wins. Nikki Haley pulled out • President Biden's State of Union drew battle lines with "predecessor" ahead of November elections • Fed Chair Powell "not far" from decision to cut • Payrolls (Feb) +275k, unemp 3.9%; AHE +0.1%mom • Fed's Beige Book noted softening consumer spend	• CPI inflation (Feb) core expected to edge lower, focus on shelter retracement and services ex-shelter • Retail sales (Feb) firmer after sharp Jan drop, gauging one-off snow disruption, or trend softening • Empire mfg (Mar) – Feb bounce start of firmer trend? • U MIch consumer survey (Mar, p) watch for further weakness
	• ECB meeting was as we expected, with depo rate maintained at 4%, a neutral policy tone, strongly hinting towards a June rate cut in line with our long held expectation • Flash estimates were confirmed with euro area flat GDP and employment growing by 0.3%qoq in Q4	• Light data week with euro area IP for January and member states' final HICPs for February
	• Budget - Chx enacts measures totaling near £50bn over forecast horizon, enabled by significant drop in the debt interest outlook and some tax reforms. The OBR estimates headroom to meet fiscal mandate just £8.9bn and only 54% chance of meeting target. Optimistic growth targets add to chance of miss • BRC total sales up 1.1%yoy in Feb. (5.2% in 2023)	• Labour market (Jan/Feb) watch for usual upward revision to AWE (ex-bonus), but overall modest slowdown should continue. Unemp. looks set to edge higher, but data still questionable • GDP (Jan) expect +0.1%mom, reversing Dec. -0.1% • RICS house prices to show further improvement
	• Tokyo CPI (Feb) 2.6% v 1.8%; core, core 3.1% v 3.3% • Conflicting commentary from BoJ members makes some in markets expect Mar hike (we expect Apr) • Rengo trade union avg pay demand 5.85% - 30y high • Services PMI (Feb, f) 52.9 from 52.5 (prel)	• GDP (Q4, f) some expectation for upward revision to business spending to lift economy out of recession • PPI inflation (Feb) modest rise expected
	• Caixin services PMI (Feb): 52.5, down by 52.7 from Jan • Trade figures for the first two months of 2024 came in stronger than expected. Exports grew by 7.1%yoy, imports grew by 3.5% • FX reserves edged up in Feb to USD3.226tn from 3.219tn	• February's CPI (9 Mar) is likely to recover from deflation in Jan due to a more favourable seasonality, though weak prices are to persist • Deflation in PPI is likely to continue in February • Credit data for Feb is critical to determine if the strong credit demand in Jan was only a one-off surge due to Chinese New Year
	• CB: As expected Malaysia (3.0%) & Poland (5.75%) stood on hold • Feb CPI (yoy): Mexico (4.4%), Philippines (3.4%) & Turkey (67%) • Q4 GDP (yoy): South Africa (1.2%) • Jan industrial production (yoy): Brazil (3.6%) & Korea (12.9%)	• CPI (Feb): Brazil, Czechia, India, Romania & Russia • Retail sales: Brazil (Jan), Czechia (Jan) & Indonesia (Feb) • Jan industrial production (yoy): India, Malaysia, Mexico, Romania & Turkey • Russian Presidential 'election'

Upcoming events		
	US:	Tue: CPI inflation (Feb), NFIB Survey (Feb); Thu: Retail sales (Feb), PPI inflation (Feb), weekly jobless, business inventories (Jan); Fri: Empire State mfg survey (Mar), industrial output (Feb), Michigan consumer sentment (Mar, p).
	Euro Area:	Tues: Ge CPI (Feb, f), Ecofin in Brussels; Weds: Ez Industrial output (Jan), ECB announces new operational framework, It unemployment (Q4); Thu: Ge current account (Jan), Sp HICP (Feb, f); Fri: It, Fr HICP (Feb, f), It government debt (Jan), retail sales (Jan)
	UK:	Mon: RECS/KPMG employment survey; Tue: Labour market release (Jan/Feb); Wed: GDP (Jan), monthly output (Jan), trade (Jan); Thu: RICS housing survey (Feb)
	Japan:	Mon: GDP (Q4, r); Tue: PPI inflation (Feb)
	China:	Sat: CPI and PPI (Feb); Fri: 1-yr MT lending operation, home price index (Feb); across week: Total social financing, M2 supply, new loans, Foreign direct investment (Feb)

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