The "Trump" Trade Deadline

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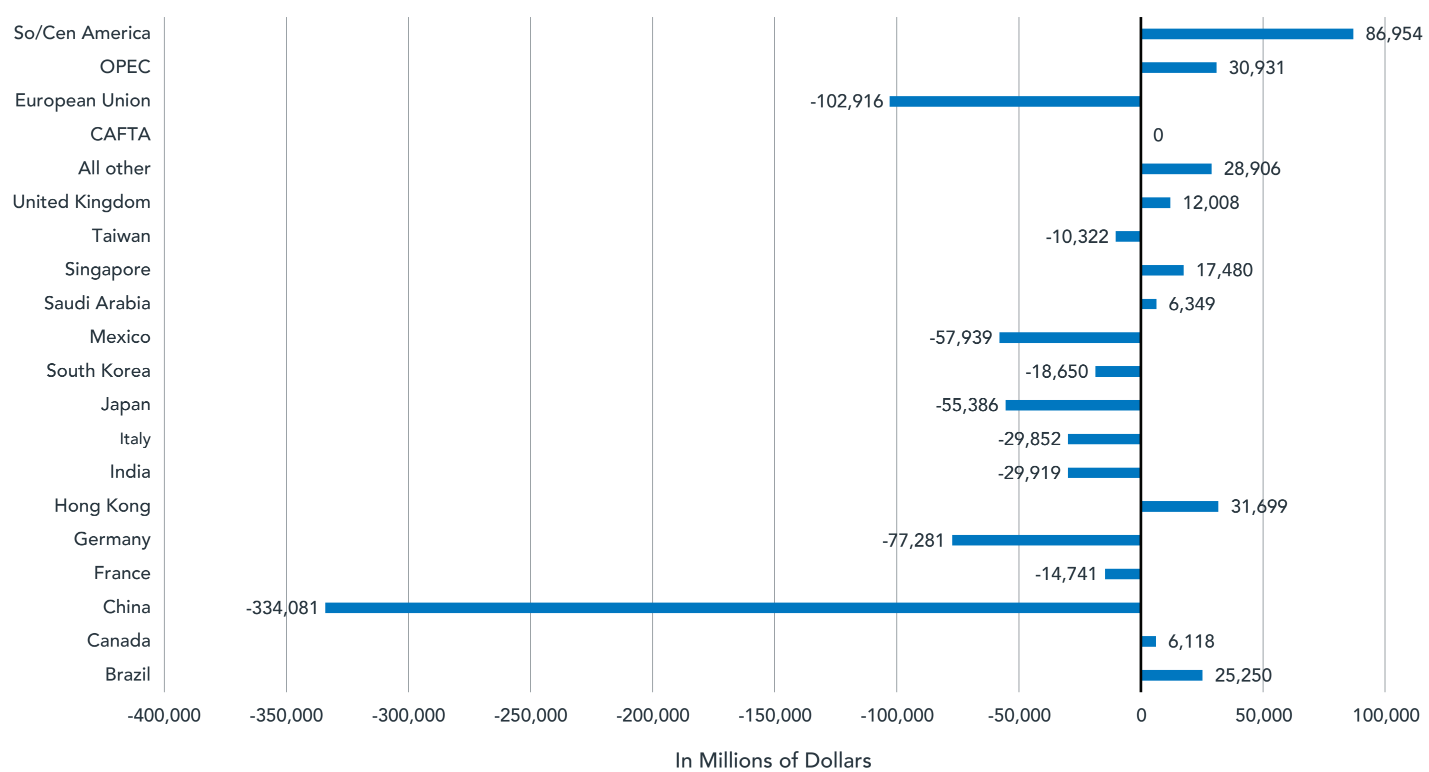
Since the financial markets learned that the 45th president of the U.S. would be Donald Trump and both houses of Congress would remain in Republican hands, the lion's share of attention has been focused on the potential positive aspects for the domestic growth outlook. Indeed, fiscal stimulus measures such as tax cuts/reforms and infrastructure spending, as well as regulatory relief, have dominated market sentiment, pushing equity prices to new heights, reinvigorating the U.S. dollar and creating one of the most powerful sell-offs in Treasuries in recent memory.

Considering the price action in these arenas, one could be forgiven for asking, did we get over our skis a little bit? In other words, are the markets exclusively focusing on only the positive aspects to the president-elect's plan? There's no doubt the aforementioned fiscal stimulus measures and relief from regulatory burdens that currently exist, if enacted, should be viewed as supportive for the U.S. economic outlook. Most analytical studies of the tax cut and infrastructure spending proposals are "scored" on a 10-year basis in terms of their impact on the U.S. budget. The same can be true from an economic perspective, with forecasts for 2017 U.S. real GDP[1] varying, but for the most part, centered on a +0.5% to +0.7% boost for the calendar year as a whole.

FIGURE 1: U.S. TRADE BALANCE BY COUNTRY/REGION (2015)



Source: Bureau of Economic Analysis, as of 11/28/16.

[1] Gross domestic product (GDP): The sum total of all goods and services produced across an economy.

Since the lion's share of the attention has been focused on the positive growth prospects, we thought it would be useful to offer "the other side of the trade," namely, what could possibly keep the euphoria to a more subdued level going forward? Obviously, the first thing that comes to mind is this: What exactly will the Trump administration and Congress ultimately agree on and sign into law? Another consideration centers on any potential negative impact that could arise from what has transpired in the financial markets post-election. To be sure, higher Treasury yields[2] and a stronger U.S. dollar could create a somewhat tighter financial conditions backdrop over the next year, while consumers will more than likely not be the beneficiary of plunging gasoline prices either.

Thus far, a Trump campaign proposal that has seemingly not received the same degree of scrutiny in the markets is the outlook for U.S. trade. The trade aspect to then-candidate Trump's platform was an integral part of the overall message, and it was certainly not a ringing endorsement for free trade. Rather, looking at Mr. Trump's Contract with the American Voter (the 100-day plan), one of the key actions on the 45th president's first day in office would be to "direct the Secretary of Commerce and U.S. Trade Representative to identify all foreign trading abuses that unfairly impact American workers and direct them to use every tool under American and international law to end those abuses immediately." More specifically, Mr. Trump's opposition to the Trans-Pacific Partnership (TPP) was well-documented, but what stands out front and center on the trade front is his dislike for NAFTA and his view of China as an unfair trading partner.

With trade potentially being in the headlines early on in a Trump administration, it is important to put some statistics in perspective. Let's take a look at the U.S. trade data for 2015, with a specific focus on China and our NAFTA partners, Canada and Mexico. As the graph above clearly reveals, there is a reason President-elect Trump has focused on the U.S. trade deficit with China. According to the Bureau of Economic Analysis (BEA), this trade gap came in at $334 billion in 2015, or more than three times the next widest deficit, the European Union's $102.9 billion. Through September 2016 (the latest data available), the BEA reported that China is maintaining course, with the U.S. trade balance being pegged at negative $257.7 billion.

It is interesting to note that prior to China becoming the largest deficit country with the U.S., the focus was centered on the trade gap with Japan. In fact, this issue was capturing headlines in U.S. political races back in the early 1990s (history does repeat itself). Going back to 1999 (the BEA data only goes back this far for China), the U.S. trade deficit with China was placed at $67.4 billion, while Japan's registered $55.9 billion. Since that time, the deficit with China has skyrocketed by nearly $267 billion while the reading for Japan has stayed roughly the same at $55.4 billion through 2015.

Turning to our NAFTA trading partners, Canada and Mexico, we see divergent patterns in place. North of the border, the U.S. actually carried a trade surplus, albeit a modest one, with Canada in 2015, amounting to $6.1 billion. Conversely, the trade gap with Mexico is the fourth largest at $57.9 billion. For the record, NAFTA went into effect on January 1, 1994. Interestingly enough, the U.S. trade position with Mexico from 1990 to 1994 produced either an essentially flat reading or modest surpluses during that time frame. In fact, from 1995 through 2015, the U.S. has been running a trade deficit with Mexico. During this same five-year period, red ink totals were usually the norm with Canada, but they were relatively small in size, only to peak at $71.7 billion in 2005. Since 2008, there has been a visible narrowing, with the aforementioned 2015 surplus the first positive reading in 24 years.

[2] Treasury yield: The return on investment, expressed as a percentage, on the debt obligations of the U.S. government.

CONCLUSION

So, what should investors expect to see on the trade front in a Trump administration? Certainly, that is a very difficult question to answer as there are many variables at play, namely, does President Trump follow through on his campaign platform's hard-line rhetoric or does the administration take a more pragmatic approach? One seemingly easy outcome would be to announce that the U.S. will not be a member of the TPP agreement. With respect to NAFTA, financial markets will more than likely hear ramped-up rhetoric regarding the imposition of potential tariffs and threats to withdraw from the treaty or, to possibly renegotiate the agreement. On an individual country basis, China certainly stands out as a potential headline maker. Based upon the 100-day plan, it would appear the Trump administration could label China a currency manipulator rather early on. After that, the uncertainty quotient gets dialed up. Both the U.S. and China already apply anti-dumping penalties for a variety of products on each other, while any threats to impose tariffs on Chinese-made goods probably would be met by China retaliating in kind.

The trade, or net export, component is one of the five key cylinders behind GDP growth. In the near term, barring any dramatic moves, it appears that there would not be a meaningful impact on the trade figures overall. However, one offshoot of the Trump victory that could impact the economy and inflation[3] has been the visible strengthening of the U.S. dollar. With the U.S. continuing to run trade deficits from a global perspective, the post-election moves in the dollar could have lagged effects later next year and into 2018, serving as a potential drag on U.S. exports and a drag on inflation, accordingly.

[3] Inflation: Characterized by rising price levels.