



# Recession, Expansion, Inflation and Stagnation



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## EXECUTIVE SUMMARY

1. There are clear signs of slowing employment which bodes poorly for both the US economy and stock market.
2. The S&P 500 index is now well overvalued by historical standards and may be due for a correction. Geopolitical risks do not appear to be factored into current valuations.
3. President-Elect Donald Trump favors the use of tariffs to raise revenue and protect domestic businesses. Unfortunately, tariffs have a history of generating inflation.
4. Trump also favors a reduction of income taxes and intends to deregulate many industries along with reducing the amount of bureaucracy in the US government.
5. While much of the Trump Administration's proposed agenda could provide a near-term economic stimulus, in the long run, there are significant risks of even greater inflation than what was seen in 2021-2023.

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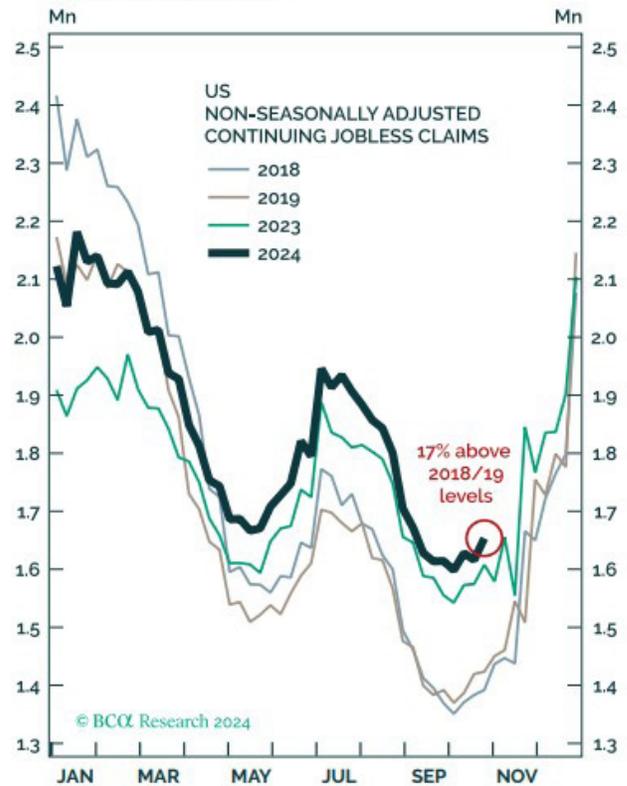
## STATE OF AFFAIRS

As of November 13th, the Republican party has essentially won control of the United States government effective in January 2025. With Trump winning the election rather handily, and with slim majorities in the Senate and House of Representatives, the GOP has claimed a mandate to govern in accordance with their platform[a]. However, there are indications that they will inherit a slowing economy.

Employment numbers have dropped rapidly over the last three months. As I suggested might happen in my previous article (2024 4thQ Outlook), the August & September labor reports were revised downwards and the October report showed only very few jobs created. In all, during this period, the US economy actually lost nearly 50,000 jobs[b]. Lower employment means less spending, corporate earnings will suffer and stock market prices will be tested.

In addition to the above, jobless claims are rising:

## Continuing Unemployment Claims Are 17% Higher Than They Were At This Point In 2018/19



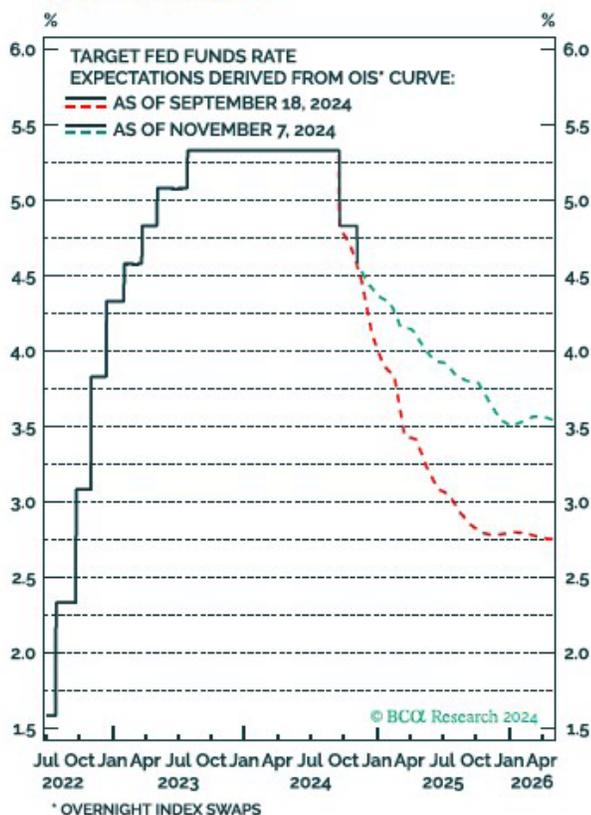
Source: BCA Research, November 8, 2024

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Investors are hopeful that Trump's pro-growth policies will sustain the ongoing economic expansion and stock market rally. This stimulus may ultimately have the desired effect but it will take time for legislation to be passed and for the economy to feel the effects. In anticipation of this stimulus, markets are now projecting slower interest rate cuts by the Federal Reserve ("Fed"):

The Market Is Now Projecting A Slower Pace Of Rate Cuts



Source: BCA Research, November 11, 2024

Stock market prices continue to ignore the potential volatility stemming from global events and how Trump's self-ascribed "Madman Theory" approach to foreign policy might ignite additional conflicts[c]. Prime Minister of Israel, Binyamin Netanyahu recently sacked his defense minister. Many interpret this to mean Israel may expand their conflict with Iran[d]. Additionally, Russia has amassed 50,000 troops on the border of Kursk, Ukraine hoping to annex more land before any negotiations begin[e]. Further, recent staffing appointees of the Trump Administration are known to be vehemently opposed to China and its policies[f].

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## OF TAXES AND TARRIFS

Mr. Trump has sold the public on the idea that other nations are taking advantage of the US through existing trade agreements. His proposed solution is to implement tariffs (a tax on goods paid by importers that inflate the cost of foreign goods) on most imports, especially on Chinese goods, in order to protect US manufacturing. The concept behind tariffs is to collect revenue from outside sources and protect domestic production. The problem is that other nations can, and typically do, retaliate with their own tariffs on US goods. If this occurs, it will send prices skyrocketing[g].

A similar idea regarding tariffs was implemented in 1930 with the objective of alleviating the economic impact of the Great Depression through the...anyone? The Smoot Hawley Tariff Act which...raised or lowered – anyone? It raised tariffs on imported goods. Did this work...anyone? It did not work and the US sank deeper into the Great Depression. If this sounded at all familiar it is because you heard it voiced by the economics teacher in the movie Ferris Bueller's Day Off! And yes, I imagine my readers' faces are right now much like the teenagers in that particular scene. ("Thank you, Simone.")



The wit and wisdom of Ben Stein, Ferris Bueller's Day Off, 1986

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Many aspects of Trump's landmark tax legislation, the Tax Cuts and Jobs Act of 2018, are set to expire in 2025. With Republican majorities in Congress, this legislation is likely to be renewed and perhaps expanded [h]. Trump has also supported reducing the corporate tax rate from 21% to 14%.

Exactly how the tax code will look in the end is anyone's guess but there is insufficient room in the budget for a further reduction in revenue. Especially if we slip into recession, the annual deficit could increase by trillions of dollars (refer to the chart below).

## DEBT AND INFLATION

One of Trump's primary talking points during the campaign pertained to deregulation and reduction of government waste. While it is an open point exactly how much this administration will be able to roll back the Federal government, unquestionably, there are certain industries that should benefit. This may include components of the financial industry including banks, investment banks and insurance companies. Healthcare, biotechnology and pharmaceutical companies may also benefit from wider operational leniency. Further a more lax approach to climate change should allow for an expansion of oil and gas exploration, which is a benefit to traditional fossil fuel energy companies[j].

Trump's much hyped plans on reducing immigration and deporting migrants could have a significantly adverse impact on the economy. By reducing the labor supply, this will artificially increase wages for businesses who will be compelled to pass along these higher costs to the consumer. This price inflation will continue until consumers waive the white flag and reduce demand thereby slowing the economy[k].

The US may also substantially increase defense spending. With the transfer of arms to allies around the world, US weapons stockpiles are low and need to be replenished[l]. The Trump Administration appears to be adopting a "peace through strength" approach to foreign policy which will necessitate an expansion of defense operations and materiel. This government spending will likely provide a near-term economic boost.

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The table below estimates that the Trump policies will increase the national debt by over \$7 trillion:

Summary of Trump Plan, Savings/Costs(-) (billions, 2026-2035)			
Policy Proposals	Low	Central	High
Extend and Modify the Tax Cuts & Jobs Act (TCJA)	-\$4,600	-\$5,350	-\$5,950
Exempt Overtime Income from Taxes	-\$500	-\$2,000	-\$3,000
End Taxation of Social Security Benefits	-\$1,200	-\$1,300	-\$1,450
Exempt Tip Income from Taxes	-\$100	-\$300	-\$550
Lower Corporate Tax Rate to 15% for Domestic Manufacturers	-\$150	-\$200	-\$600
Enact or Expand Other Individual and Small Business Tax Breaks	-\$150	-\$200	-\$350
Strengthen and Modernize the Military	-\$100	-\$400	-\$2,450
Secure the Border and Deport Unauthorized Immigrants	\$0	-\$350	-\$1,000
Enact Housing Reforms, Including Credits for First-Time Homebuyers	-\$100	-\$150	-\$350
Boost Support for Health Care, Long-Term Care, and Caregiving	-\$50	-\$150	-\$300
<b>Subtotal, Tax Cuts and Spending Increases</b>	<b>-\$6,950</b>	<b>-\$10,400</b>	<b>-\$16,000</b>
Establish a Universal Baseline Tariff and Additional Tariffs*	\$4,300	\$2,700	\$2,000
Reverse Current Energy/Environment Policies and Expand Production	\$750	\$700	\$550
Reduce Waste, Fraud, and Abuse	\$250	\$100	\$0
End the Department of Education and Support School Choice	\$200	\$200	\$0
<b>Subtotal, Revenue Increases and Spending Reductions</b>	<b>\$5,500</b>	<b>\$3,700</b>	<b>\$2,550</b>
<b>Net Interest</b>	<b>-\$200</b>	<b>-\$1,050</b>	<b>-\$2,100</b>
<b>Total, Net Deficit Impact</b>	<b>-\$1,650</b>	<b>-\$7,750</b>	<b>-\$15,550</b>

\* THE UNIVERSAL BASELINE TARIFF IS ASSUMED TO BE 20% IN THE LOW-COST ESTIMATE, AND 10% IN BOTH THE CENTRAL AND HIGH-COST ESTIMATE. THE CHINESE TARIFF IS ASSUMED TO BE 60% IN ALL SCENARIOS. THE HIGH-COST ESTIMATE ALSO INCORPORATES REVENUE LOSS FROM POTENTIAL DYNAMIC EFFECTS, SUCH AS A REDUCTION IN GDP. SOURCE: COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET. NOTE: FIGURES ROUNDED TO THE NEAREST \$50 BILLION.

Source: BCA Research, November 8, 2024

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## CONCLUSION

### **So why should you worry?**

If the Trump administration is able to pass its agenda as outlined in the campaign, the long-term economic impact could be severe. I suspect that due to the time lapse between inauguration, passing and implementation of new stimulus and the market impact timing, the US economy may soon experience a mild recession. Once this stimulus takes effect, we could see an economic expansion as incomes rise. Unfortunately, Trump's policies will likely spur inflation; if not properly managed, the result could be worse than what we experienced in 2021 thru 2023. If so, the economy may end up mired in stagflation: a period of slow growth, higher unemployment and rising inflation.

### **And from where you can take solace?**

It is far from certain exactly what Trump will do and what he will be able to do. The Republican majorities in both the Senate and House of Representatives are relatively slim. While Trump greatly values loyalty, elected officials may not fall into line on every issue to follow a lame-duck president. As such, it is very possible that some of the policies espoused during the campaign may be watered down or not implemented at all.

Lastly, watch carefully how the Democrats respond after this election. The last time their party platform was rebuked in this manner was 1988 after George H.W. Bush defeated Michael Dukakis in the Presidential election. Shortly after, the Democrat party elders decided to select someone to head the newly established Democratic Leadership Council. They wanted a young and charismatic individual with new ideas who could take the party in a different direction. They nominated William Jefferson Clinton[m].

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