Matthew Fienup
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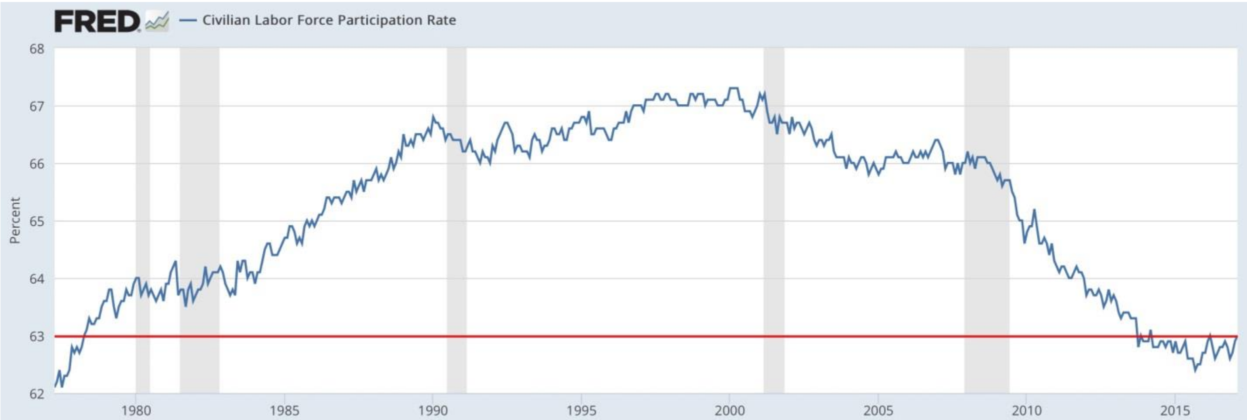
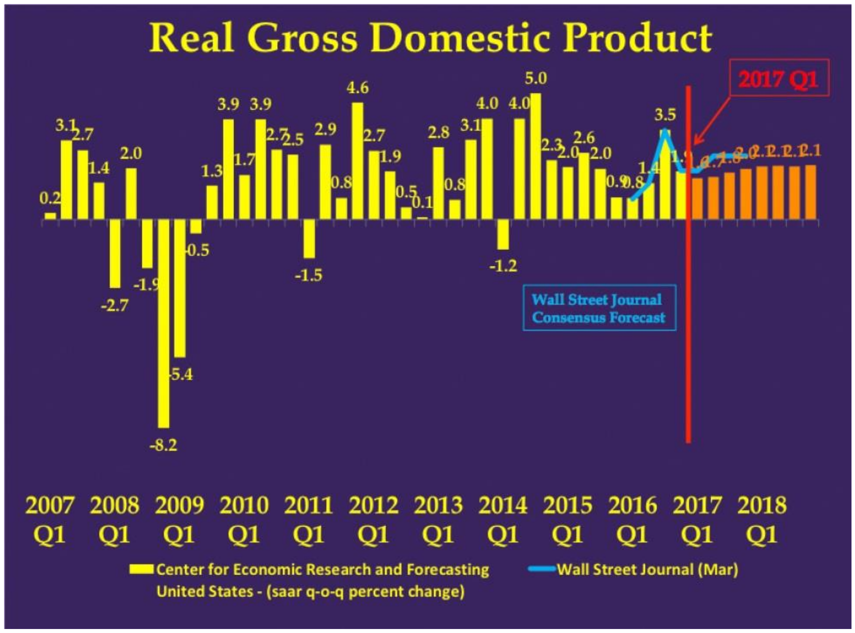
In the four months since the Presidential election, markets have rendered a stunning verdict regarding the economic outlook under the Trump Administration. On March 1, 2017, the S&P 500 reached a record high close, having climbed 12 percent since election day and added nearly 2.4 trillion dollars in total market cap. Market participants are betting that the new administration will change regulatory and corporate tax policies, which are among the primary drivers of the poor economic performance that has plagued the U.S. economy since the Great Recession.

Ever contrarian, the CERF team departs from the view held by markets participants. We do not foresee significant reforms of the type that would fundamentally change the trajectory of the economy. Going further, we reject the assertion of some economists that Donald Trump is inheriting a "fundamentally strong" economy. Growing at approximately half the historic rate which characterized the U.S. economy between 1947 and 2007, we see an economy operating at well below potential and one which could not withstand a significant external shock. We also reject the notion that the current unemployment rate characterizes a labor market that is anywhere near "full employment." To find labor force participation as anemic as today's you need to look all the way back to 1978, prior to the dramatic employment gains enjoyed by women in the 1980s.



The current U.S. economic forecast calls for continued slow growth for the entire forecast horizon. The current GDP forecast is nearly indistinguishable from the previous publication's.



The risks to our forecast remain to the downside. Aside from worrisome changes to U.S. Monetary policy, discussed in detail in the nearby U.S. Highlights essay, there are a few changes to our policy assumptions that have slightly increased downside risk compared to the previous forecast.

Most notably, the probability of meaningful regulatory and corporate tax reform seems to be decreasing. In December, we assigned only moderate (meaning 25 to 50 percent) probability to these reforms, yet the early signs from the Trump administration and Congressional Republicans lead us to downgrade the probability. Operating through the House Republicans' tax reform package, the probability of an international trade war seems to have actually increased significantly.

For the previous forecast publication, we assembled a matrix that includes each of the policy positions discussed during the Trump campaign which, if enacted, could have a significant impact on economic activity. That matrix is reproduced below, and we encourage readers to visit the Q4 2016 U.S. Forecast essay for a thorough discussion of the specific policy components and their implications. Here, we add a new column after the probability of implementation. It describes the change that we have made to the initial probability. International trade and regulatory reform warrant further discussion below.

	Impact on GDP	Impact on Deficit	Prob. Implementation	Recent Prob. Change
Corporate Tax Reform	increase	decrease	moderate	decreasing
Regulatory Reform	increase	decrease	moderate	decreasing
Trade Protectionism	large decrease	increase	low	increasing
Deportations and Immigration Reform	decrease	increase	low	no change
Infrastructure Spending	decrease	increase	high	no change

International Trade

While the House Republican Tax Reform plan includes provisions that are pro-growth, most notably a reduction in the top Corporate Tax rate to 20 percent from 35 percent, it also includes a border-adjusted tax measure that might easily propel the country into an international trade war.

The Orwellian sounding "Better Way" tax reform would impose a 20 percent tax on all imports while providing an exemption for all export-related income. The import tax functions by denying companies the ability to deduct import costs from taxable income. A company selling imported goods would pay tax on the entire sale price, rather than on the profit. U.S. companies selling exported goods would be allowed to exclude revenue from exports from their taxable income. In this way, the policy would provide a direct subsidy to exporters. If this seems like a tariff masquerading under another name, it is.

Washington tax lawyers seem to disagree whether this violates international trade agreements; however, China and other trade partners have already announced their intention to retaliate if the border-adjusted tax becomes policy.

The plan stands in stark contrast to economic consensus. While economists tend to agree on very little (recall the old joke, the *First Law of Economists* is, for every economist, there is an equal and opposite economist), there is near unanimity on the effect of free trade. That is, both sides benefit from free trade, and both sides are made worse off in a trade war. A survey by the American Institute for Economic Research found that 83 percent of economists agreed that the U.S. should "remove remaining barriers to trade." In the survey, there was greater agreement among economists on free trade than on any other single economic policy. Unfortunately, one of the few economists in the profession that supports trade protectionism now heads the President's *National Trade Council*, in Washington D.C.

Regulatory Reform

As discussed in the nearby US Economy essay, meaningful reform of ObamaCare looks increasingly unlikely, especially now that the CBO has rendered its verdict on Republicans' health care reform. A significant political defeat on ObamaCare replacement would remove all political momentum and very likely kill the hope of other significant reforms prior to the 2018 mid-term elections.

The President's executive order on new regulation certainly sounds nice (for every new federal regulation, two must be rescinded), yet as a policy, it seems like symbolism over substance.

Even if the order serves as an effective moratorium on new regulations (it may not), it is not clear how it can be used as a tool for achieving repeal of the most damaging regulations of previous administrations. Congress' use of the Congressional Review Act seems more promising. We just hope that Republican's wield the Act with boldness, not with the timidity that we have come to expect from the group.

Forecast charts are included on the next page.

Forecast Charts