# Tuesday Comments November 15, 2016

It's advertised that there is a "new political order" in town.

What does the "new political order" plan to accomplish **economically**? Although the devil is in the details, which we do not yet know, we can assume the following:

**Fiscal Policy**

Faster economic growth was promised. Tired of 2% real economic growth, the plan is to do better…4% or more. To do this "the order" will use something that hasn't been used for the past six years - Fiscal Policy. Taxes will be cut. However, there are presidential and congressional competing tax plans. Because of these high expectations you should assume that in America for the remainder of this year, reported personal income should plunge. This should not be worrying because January of next year will see a great improvement. Moving income late in the year to a lower tax rate year is an American tradition. Under all the plans, tax rates will fall and the largest recipients by far will be higher income tax brackets (to expand on this we will review Milton Friedman's Permanent Income Hypothesis next week, which was originally planned for today).

The means to pay for reduced taxes should come with some legislative conflict. To maintain the same deficit there will need to be a reduction in government spending…and it will be up to you to spend your tax savings.

On the other hand, there is the proposed one trillion dollars of spending over ten years on infrastructure. This is not a government spending plan but rather a private sector tax credit on 82% of the equity in infrastructure projects. Since the attempt to make a profit is there, somehow whatever is an "infrastructure" we must assume requires a revenue source. Think about building a school and leasing it to the school district. So what if it looks like a strip mall.

Aggregate demand will be stimulated, but details are still lacking. To increase the deficit is Keynesianism at its best. To maintain or decrease the deficit is supply-side economics at its best. These theories work, right?

**Less Regulation**

Regulation stymies economic growth, so the less regulation there is, it follows that there should be more economic growth. In this area we have to assume that many of the Dodd-Frank regulations on banks and derivative products will go by the wayside. If this happens there may be a complicated ending, since Dodd-Frank cuts across many government agencies and the Federal Reserve. If this happens the evidence will be friendly phone calls from your bankers. Additionally they will have some great new derivative products that you will want to buy. Just what you needed!

Swaps can be a life-altering financial product, and the health insurance industry will be impacted by changes in, or replacement of, the Affordable Care Act. Prior to the Great Recession the largest reason for foreclosed homes was for uninsured medical expenses. It is unsure at this time how it will be replaced, but this will have an impact on future consumption.

**Foreign Trade**

If you like uncertainty this is the one for you! As we have written about this many times in the past, free trade is not good for a high-wage labor market such as the U.S. This in fact may be the essence of the outcome of the national election. Free Trade is good at providing lower prices, but with less free trade expect prices to increase somewhat. Windows, lumber, steel, and miscellaneous other gizmos will cost more. American industry has voluntarily made changes in its production function over more that two decades of free trade. If there are sudden changes in rules of trade, expect dislocations. How does a change in a free trade agreement affect a company that has a supply chain wrapped around the world? All of these issues remain unanswered, but they simply increase economic risk. The economic impact of reducing free trade is negative for the product markets and for economic growth.

**Then there is the Fed…**

Since 2010 the only source of government stimulus has been the Fed with its zero-rate policies. The current president-elect has disdain for the current Fed chairperson, whose chairmanship expires in February 2018 (but has a term as a member of the FOMC for ten more years). We must assume she will not be re-appointed. Additionally there are two FOMC seats (out of seven) that have been vacant for a long time. These will likely be filled in short order, and the appointments could tell a lot about the Fed and the monetary policy views of "the new political order".

For the last many years you have enjoyed the low-rate stimulus policy of the Federal Reserve System. You have profited by it. There are however several draconian and/or archaic ideas lurking in the background. They include running the Federal Reserve by formula (the Taylor Rule), shrinking the balance sheet (which the Fed has promised to do after short-term rates are normalized), or even the restoration of the Gold Standard. Any change in the stability of the Federal Reserve System is not good at any time for any reason.

All of the above may be summarized as "be careful what you wish for, it may come true". Your borrowing costs will be higher, but at least your banker will return your phone calls. You may be doing a new deal, but your input cost will be higher. You may have more after-tax income, but don't forget you need to spend it to keep the economy growing.

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