MACRO STRATEGY | Economic Monthly

# Trump 2.0: Back to the Future?

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By the end of this month, President Trump will enter the White House for his second term with an economic backdrop quite different from that of his first term. While the policies he advocates for are of a similar style this time around, the entirely different economic situation means that those policies may have a different effect than they would have had in his first term.

## Where Are We Today?

| Metric | At First Inauguration | At Second Inauguration |
|---|---|---|
| GDP (Q3 annual average) | 1.8% | 3.0% |
| Output gap (Q3) | 0.1% | 1.1% |
| Productivity (12 mo. MA) (Q3) | 0.1% | 0.5% |
| Y/Y CPI (Dec.) | 1.7% | 2.9 % |
| Unemployment (3M Avg.) | 4.8% | 4.1% |
| Quits rate (Nov.) | 2.1% | 1.9% |
| Layoffs rate (Nov.) | 1.1% | 1.1% |
| Prime age LFPR (Dec.) | 81.3% | 83.4% |
| Average Weekly Earnings (YoY%) | 2.4% | 3.6% |
| Public Debt-to-GDP (Q3) | 75% | 96% |
| Consumer Debt-to-GDP (Q3) | 65% | 61% |
| Corporate Debt-to-GDP (Q3) | 75% | 74% |
| Profits to GDP (Q3) | 9.3% | 10.7% |
| Policy rate (upper bound, January) | 0.50% | 4.50% |
| Long-run Fed Funds (SEP, Dec) | 3.0% | 3.0% |
| 10 Yr Yield (Jan. 10) | 2.38% | 4.76% |
| 2s10s (Jan. 10) | 1.19% | 0.38% |
| IG credit spreads (Jan. 10) | 122 bps | 80 bps |
| HY credit spreads (Jan. 10) | 388 bps | 274 bps |

*Source: BLS, BEA, CBO, NY Fed, Federal Reserve, Bloomberg, Macrobond, MIM. As of 1/10/2025.*

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Aside from a strong labor market, the economy of today has little in common with the economy of eight years ago, when President Trump was inaugurated for his first term. We point out a few key differences and how these are likely to interact with President Trump's second term agenda.

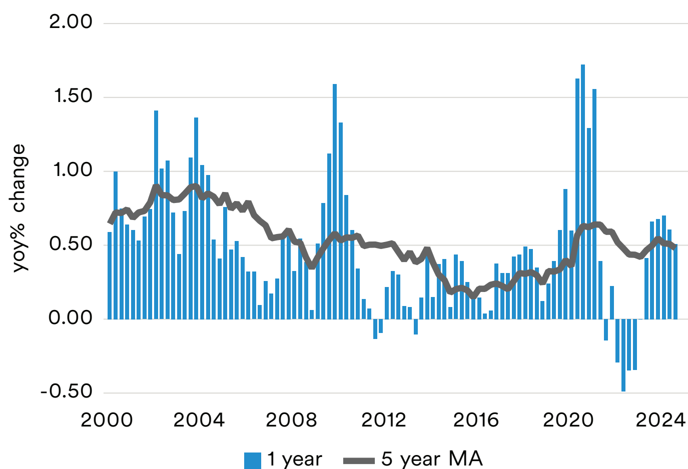
## From Cold to Hot

In 2017, the economy was still struggling to emerge from the Great Financial Crisis (GFC) doldrums. Productivity was low, the output gap was at neutral, and GDP growth was sluggish.

In the current environment, the output gap—aka the "inflationary gap"—is very positive, and GDP and inflation are both running relatively high.

In the former environment, the Tax Cut and Jobs Act (TCJA) stimulated activity with little risk to inflation. In the current economy, an extension of the TCJA could be both stimulative and inflationary.

**Chart 1 | Will Output per Hour Continue To Improve**




*Source: Federal Reserve, FRBNY, MIM. As of 1/14/2025.*

Trade policy also poses more inflationary risks than it did in 2017. The trade war with China during the first administration took place under low-inflation conditions. Now, after a period of inflation and already high price levels, consumers appear to be more price sensitive and more likely to push back against price increases. Companies have been having increasing difficulties passing cost increases on to shoppers. Firms face a bigger risk of margin compression from tariffs than they did in 2017.

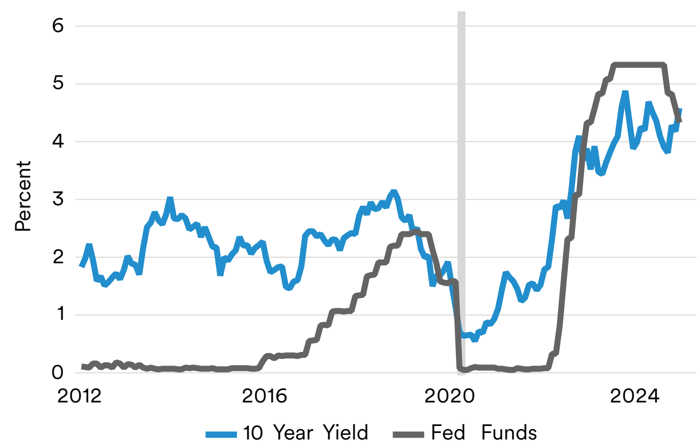
Increasing tariffs to a global scale would exacerbate this effect, and it is not clear that markets and companies would tolerate the uncertainty and volatility after taking steps to "tariff-proof" their supply chains.

Productivity growth is a wildcard. If productivity growth continues to improve, as it has over most of the last decade, aggregate supply could accelerate to meet aggregate demand and raise growth without increasing inflation.

## From Placid To Volatile

President Trump entered office in 2017 in a very different interest rate environment than this time around, which could further constrain his policy.

**Chart 2 | Rates are Substantially Higher Today**




*Source: Federal Reserve, FRBNY, MIM. As of 1/14/2025.*

In 2017, rates were very low and the zero lower bound was a preoccupation. The yield curve term premium was solidly positive. And the Fed had clear directionality: upward and away from the zero lower bound.

In 2025, we have both nominal and real rates that are substantially higher. The zero lower bound has disappeared as a concern. Term premiums are barely positive—although they are normalizing.

Most importantly, the Fed no longer has a well-defined path: although most observers expect a pause or cuts, only one cut is priced into the market at the moment. The entire range of Fed options—cut, pause, hike—is in play, at least in the medium term. Globally, central banks are diverging, with most countries looking considerably weaker than the U.S. and creating a more difficult U.S. export environment.

The new administration and Congress, much to the dismay of the markets, don't appear likely to focus too heavily on fiscal restraint. With higher rates, any tax cut extensions, new industrial policies, or technology-neutral tax credits will happen with increasingly higher cost to the government (and ultimately the taxpayers). Combined with an already strong economy, expansionary fiscal policy may further complicate the Fed's monetary policy choices.

## U.S. Outlook Summary

We expect growth in 2025 to be roughly on par with that of 2024, avoiding a recession and growing slightly above trend.

Consumer balance sheets remain comfortable, and the labor market looks to be stabilizing after a period of softness. Wage growth has remained solid. Corporate profits remain robust and could support an increase in investment.

With the incoming Trump administration, we expect the noise-to-signal ratio to be very high, providing continued volatility across markets. We expect tariff policy increases early in the second Trump administration, although inflation effects are likely to be muted, with margin compression a greater concern.

We would expect government spending—a major supporting player in the recent growth story—to be pared back over the next six to 18 months. Stimulative effects and fiscal deficit increases could arise from an extension of the Tax Cuts and Jobs Act.

We expect the Fed to continue to move slowly toward the neutral rate by cutting two more times by year-end 2025. A moderate pace fits with the Fed's considerable uncertainty about where the long-run neutral Fed Funds rate is, even as we expect inflation will take longer to converge toward 2%.

### MIM Forecast

| U.S. | 2024 | 2025 |
|---|---|---|
| GDP | 2.0 | 2.0 |
| CPI | 2.9 | 2.8 |
| 10 Year | 4.25* | 4.25 |
| Policy rates (upper bound) | 4.50* | 4.00 |
| Unemployment | 4.1 | 4.3 |

*Actual; other data are forecast.

*Source: BEA, BLS, U.S. Treasury, Federal Reserve, Bloomberg, MetLife Investment Management. As of January 2025.*

## Risks

We see a risk that the Federal Reserve doesn't cut the Fed Funds rate in 2025. If inflation and the labor market continue on their recent path, additional cuts might become harder to justify—particularly if the data indicate that the neutral rate is (even) higher than the Federal Open Market Committee (FOMC) currently believes it is.

President-elect Trump's stance on tariffs, immigration, and other matters could create a range of escalatory economic situations including a tit-for-tat trade war and the labor effects of new immigration policies. Pro-growth strategies by the incoming administration, particularly in the context of an already strong economy, could create overheated conditions.

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