

Economic Outlook Gets Trumped!

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Agenda

1. New government will inherit a strong economy
2. And now the hard work begins... forecasters agree to disagree on outlook

Trump Inherits A Strong Economy

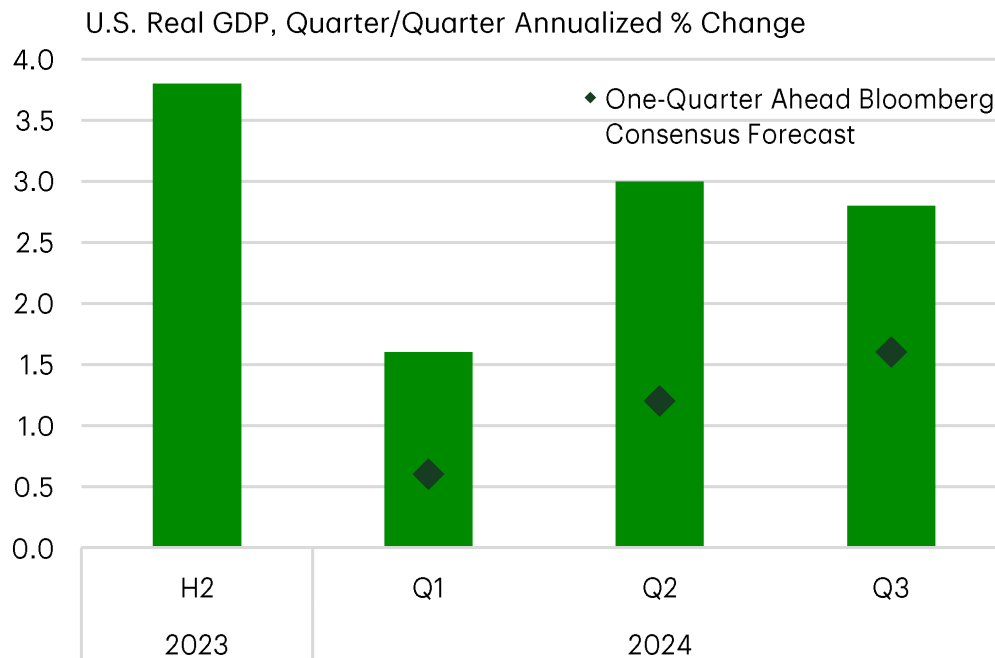
Starting points matter for a new administration, and President Trump will be inheriting a strong economy.

Another way to think of this is that it affords more leeway to implement tariffs and immigration policies to meet key election promises, because there's a cushion to absorb any short-term negative economic impacts.

But the main message of this slide is a familiar one: the U.S. economy keeps beating expectations.

The black dots in the graph represent the consensus for each quarter. The miss to analyst expectations is a full standard deviation or greater than traditional deviations.

The economy is not only outperforming people's expectations, it's doing so by a statistical mile!



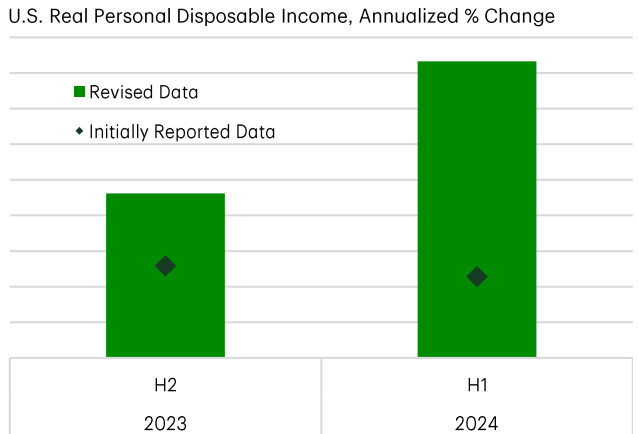
Source: Bureau of Economic Analysis, Bloomberg, TD Economics.

And Data Revisions Revealed Even More Economic Tailwind

Before I throw myself and peers under the bus, one key reason that models and analysts have underestimated is because they were given imperfect information.

Benchmark revisions to after-tax income revealed how it was possible for consumer spending to sustain strength when the initially reported data was telling us that excess savings had all but disappeared. Because it didn't. There was still plenty of savings. There's a big difference in how analysts interpret a 1% gain in real after-tax income in H1 2024 versus an outsized 4%!

Likewise, the savings rate benefited from a large restatement.

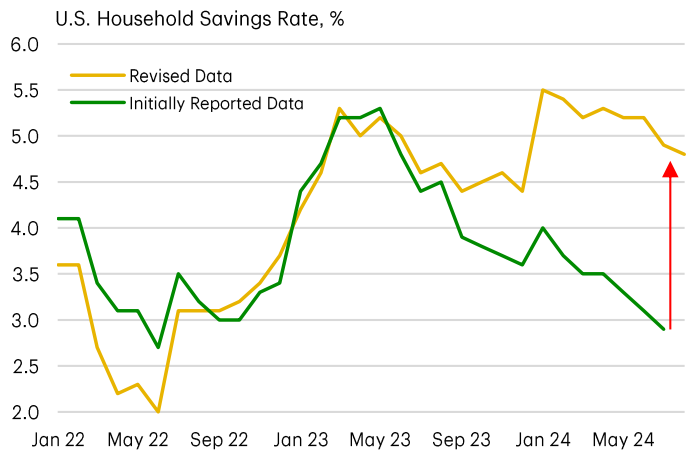


Source: Bureau of Economic Analysis, TD Economics.

Simply put, the data revisions created a new narrative. Household finances are in much better shape than the original data led us to believe.

This all works to the advantage of Republicans heading into 2025.

Some economic pain can be absorbed by households with this fatter cushion, particularly when compared to the economies of trading partners that are trading water as their starting point.



Source: Bureau of Economic Analysis, TD Economics.

Trump Policies At A Glimpse

Now let's dive into how this growth-cushion can be adjusted in our forecast.

This is called a waterfall graph. The grey bar on the left is the forecast before the election outcome was known. The U.S. economy was already projected to cool next year with some winding down of the consumer cycle. But at 2.1% GDP growth, it was essentially a return to trend.

As you move to the right on the graph, incremental adjustments are added for each policy assumption on how much it reduces or adds to that original forecast.

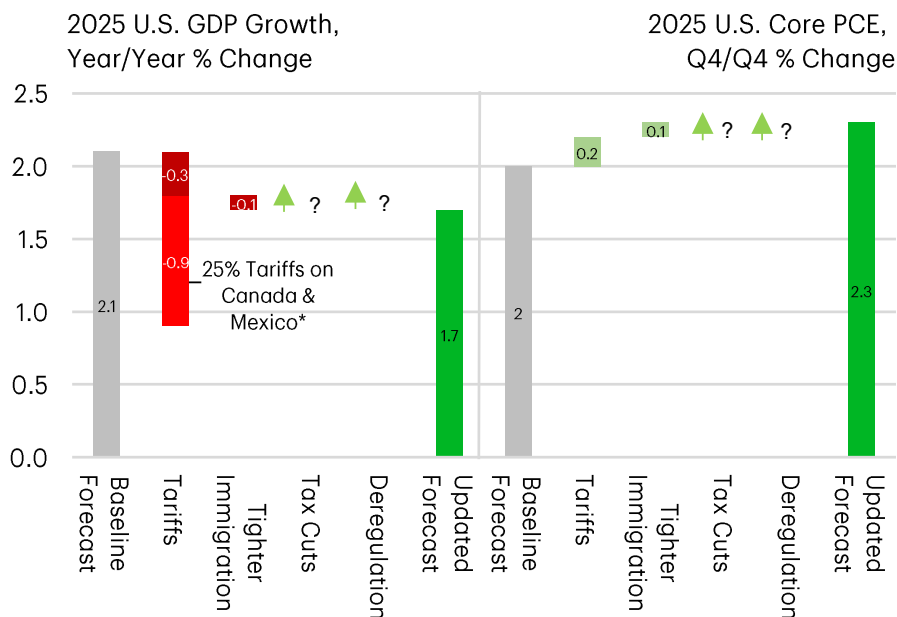
Tariffs carry a big debate on timing, magnitude, and scope, but there's no debate that it will be the go-to policy tool, as we saw with Trump's recent 25% tariff threat on Canada and Mexico.

So, it's a safe bet to include some impacts as a placeholder in the baseline forecast, even though implementation and timing is not fully known.

This 30-basis point markdown assumes that less than half the tariffs are sustained for one year relative to what we heard during the election cycle. If we went full tilt, it results in economic stagnation, assuming retaliation by trade partners.

That produces a counter-productive and counter-intuitive outcome for an administration that emphasizes how their policies lead to stronger economic growth, stock market gains and lower inflation. And, our hope is that Scott Bessent, nominated to lead the U.S. Treasury Department, will be pragmatic in ensuring the least damage as possible to the domestic economy when tariffs are used to drive a fast deal.

If we embed the tariffs Trump recently announced on Canada and Mexico, and assumed retaliation, then there's an additional economic drag of 90 basis points. The baseline GDP forecast would be revised from 2% growth to a mere 1%. But let's put a pin in that one until we come to the Canadian section.



*Includes retaliation. Source: Bureau of Economic Analysis, TD Economics.

Moving to the right of the graph, there's an estimated 10 basis point hit from immigration policy. Here too there's high confidence of follow-through but, again, differing views on timing, magnitude, and scope.

Here we've assumed stringent border control occurs immediately, but large-scale deportations are slower on lift-off due to greater complexity with execution.

And where you see the question marks in the graph, there's no placeholder on policy within the forecast. This means there's upside potential that could easily return us back to the original baseline of 2% or more. For instance, corporate income tax cuts, alterations to the SALT deduction threshold, and meaningful de-regulation that promotes business investment. However, given the very slim majority in the House, which controls this outcome, it's best to take a wait-and-see approach.

The income tax cuts under TCJA were already in our baseline because we never assumed the sunset clause would occur. So, no adjustments are needed unless Congress fails to approve the full suite of income tax cuts.

Forecast Uncertainty Underscored By Large Variation In Peer Views

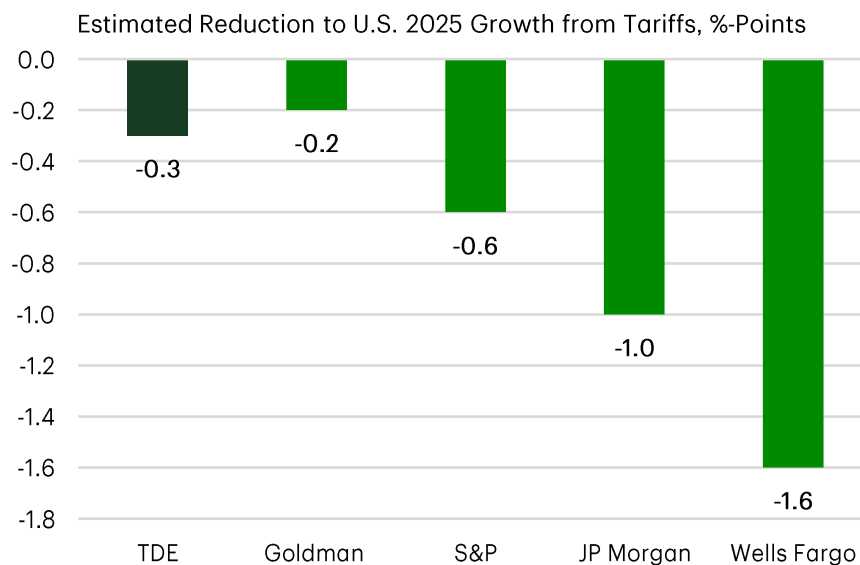
To give you an idea of the degree of uncertainty on forecast estimates, here are peer views on the negative impact to GDP from tariffs.

Our view is akin to Goldman Saks which maintain the full extension of the TCJA, a selection of tariffs applied to countries, alongside some offsetting tax breaks.

Wells Fargo and JP Morgan appear to stand out as highly pessimistic, but that's because both estimates reflect what could happen if a Trump administration delivers simultaneously and immediately on the 60% tariffs against China and 10% against all other countries.

But this is not necessarily what they've baked into their official baseline forecast. It should only be viewed as illustrative of the many possible pathways and scenarios that can be produced.

For instance, Bloomberg Consensus reveals a median GDP estimate for 2025 of 2%.



Source: Published reports from listed institutions, TD Economics.

Mass Deportations Would Hit Some Sectors Hard

Let's now turn to immigration and deportations, and why I've tempered the assumptions relative to rhetoric.

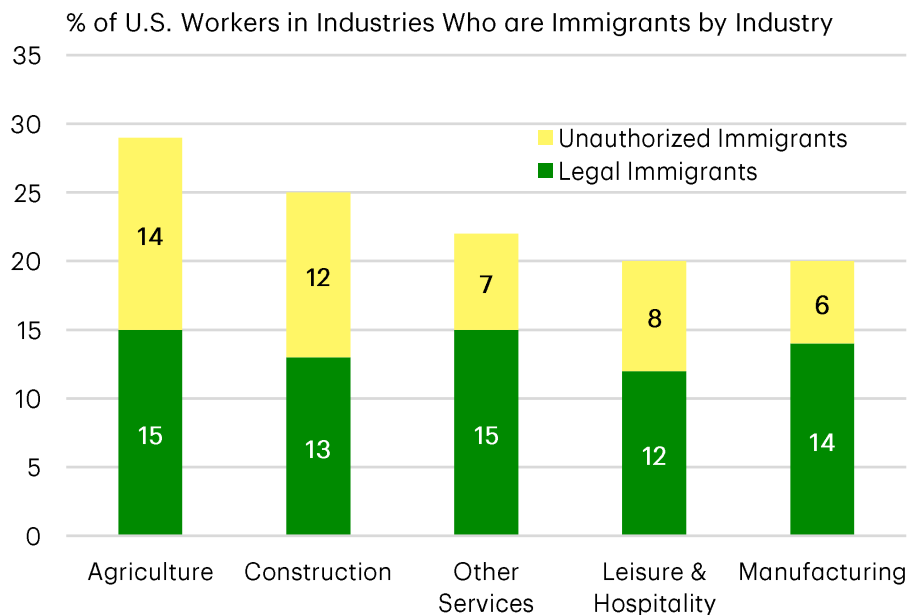
There are some big numbers floating out there on deportations, from 3 million over President Trump's term to as high as 11 million.

Relative to our previous baseline, our forecast has almost 2.5 million fewer individuals entering the U.S. by the end of his term. We haven't included anything yet on deportations because it makes a difference in how entrenched those people are in the labor market. Recently there's been some refinement on the message to target gang members and those with criminal records.

Should President Trump follow through with mass deportations of 1 million people or more, there is a real risk of reigniting labor shortages in industries with a high concentration of undocumented immigrant workers.

The agriculture sector is grabbing a lot of media headlines and the Wall Street Journal recently reported that about two-thirds of crop-farm workers are foreign-born, of which almost half (42%) are not legally authorized to work in the country. Basically, when you do the math, that sector has double the undocumented workers relative to what's shown for the agriculture sector, as a whole, in this graph. That data was based on a survey from 2020 and also found that the vast majority of farmworkers have been in the U.S. 15 years or more, and many have children born in America.

The bottom line is that the data hits home on the complexity of the situation and why we must be careful in incorporating bold deportation assumptions within our forecast without clear guidance.



Source: Pew Research, TD Economics.

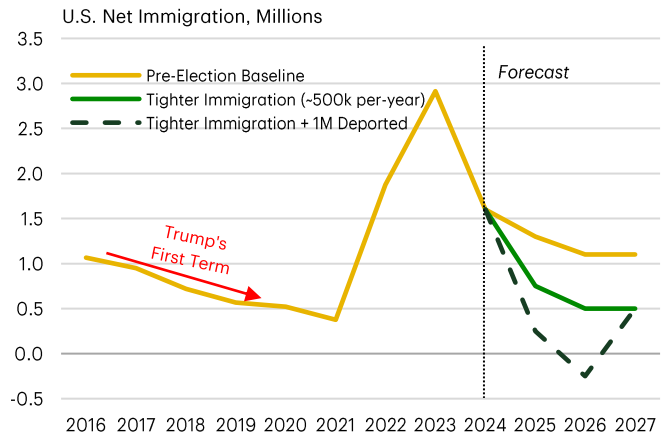
The Highs and Lows Of Immigration Impacts

But it's certainly realistic to believe President Trump will, at the very least, repeat the success of his first term regarding tighter border control, which is the bright green line in this graph. If we made a hard-lined assumption on an additional one million deportations in the coming year, naturally the impact to GDP would be deeper.

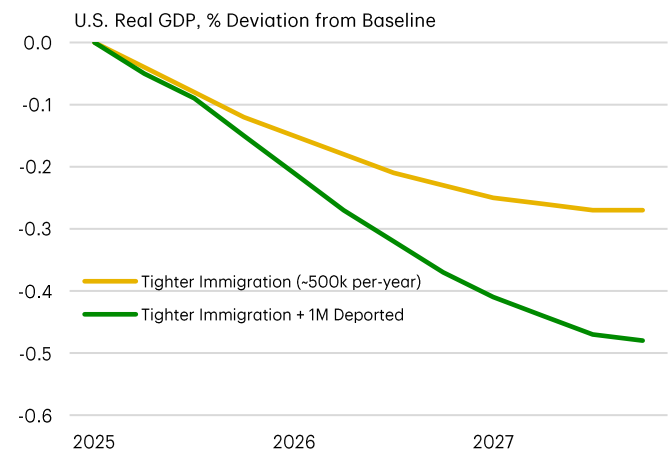
And by extension, the unemployment rate would dip, but not nearly as much as many are suggesting. A low unemployment rate is often viewed as a gauge of an economy's vibrancy. But in this case, it equates to a supply-side shock to the labor force.

However, take a look at how small the numbers are on the left side scale showing a small deviation from the baseline. Some analyst reports emphasize the negative labor force impact. But the unemployment rate is a ratio and there would be some offset from more people domestically needing to be employed, thereby reducing the ranks of the unemployed.

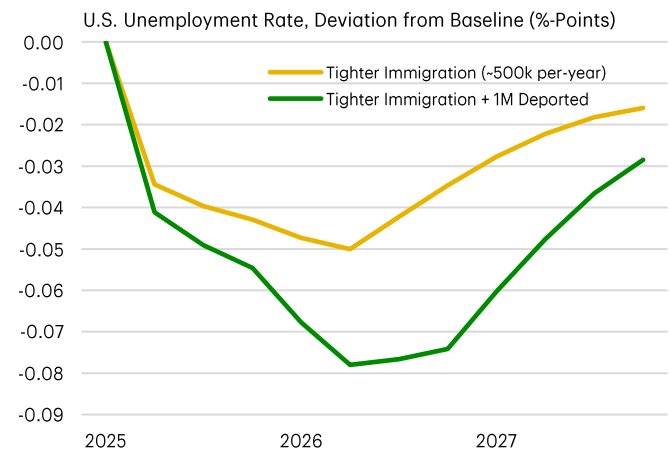
We know companies won't be able to fill all jobs, with people lacking the experience and the appetite for this type of work, which is why the argument that the policy is inflationary still holds. Wages would have to go higher to attract people and product or service supply could be less without a dramatic rise in productivity.



Source: Census Bureau, TD Economics.



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Source: Bureau of Economic Analysis, TD Economics.

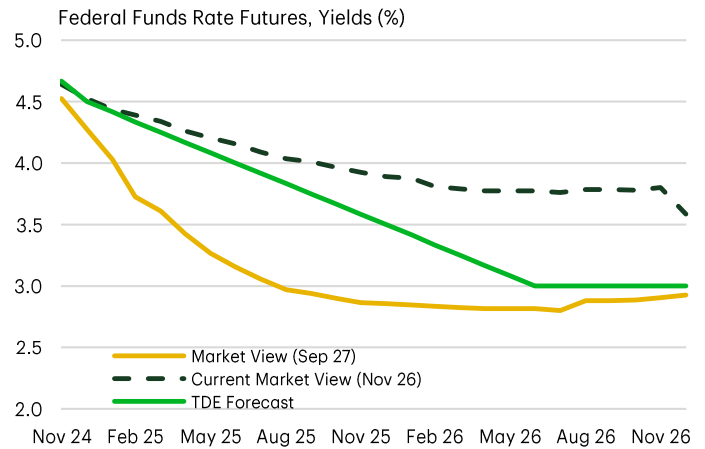
Markets Agree Of Slower Reduction In Interest Rates

Yields are one area where markets have agreement.

Although equity markets cheered the election of President Trump and the red wave, bond investors adjusted expectations that larger budget deficits, tariffs, and slower population growth will force inflation higher.

We agree the Federal Reserve will have to tread more carefully and scaled back our rate-cut expectations. The Fed gets to our 3% neutral interest rate view in the first half of 2026, which is six months later than initially forecasted.

It is in this time-period where we gap to the market view because estimates of neutral have been lifted following the election to be closer to 3.5-4% relative to the market's September view of 3%. It is not unusual for market pricing to show a gap the further out in time, given the high degree of policy and geopolitical uncertainty. However, I'm doubtful a Trump presidency changes a long-term anchor by a full percentage point or, at least, let's see what's to come on deficits and inflation before embedding a dramatic change.



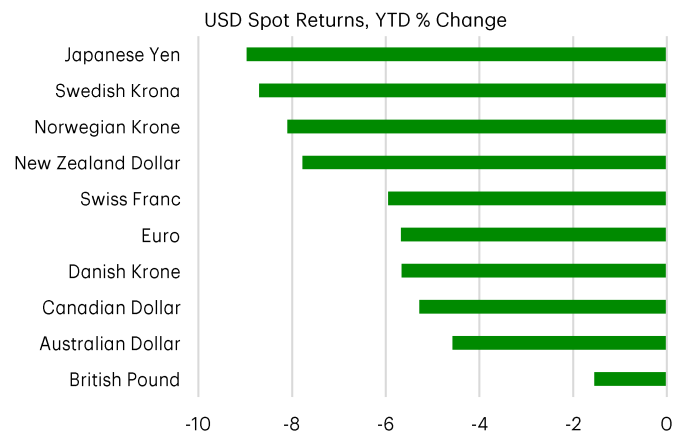
Source: Bloomberg, TD Economics.

U.S. Dollar Bulls Help Offset Tariff Impacts

With bond yields expected to stay elevated by about 30 basis points through next year relative to our pre-election view, it helps cement U.S. dollar strength, given its economic outperformance to peers alongside policies that will incent an inward pull on U.S. investment.

Greenback strength taps down inflationary pressures from tradeable goods, as tariffs are imposed. It's a reminder that policies are not all a one-way road on inflationary pressures, there are some counterbalances naturally created in market dynamics.

As tariff policies are revealed and imposed on various countries, there will be further near-term upside to the greenback relative to those currencies.



Note: Data as of November 26th, 2024. Spot returns calculated using USD as base currency. Source: Bloomberg, TD Economics.

Summary

- Trump will inherit a resilient economy – where to from here?
- Increased trade protectionism and mass deportations pose notable downside risks to the outlook
- But don't forget the upside that's harder to quantify: friendlier regulatory environment and potential for other tax cuts.
- A more cautious Federal Reserve is likely on deck for 2025

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