After Trump’s win, fiscal policy and inflation risks in focus

US growth prospects, equities favourable in the short term, but fewer hurdles to fiscal expansion pose longer term risks

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Republican candidate and former president Donald Trump gained a decisive majority of electoral votes in the US presidential election. Meanwhile, Republicans have also secured a majority in the Senate, while, at time of writing, the counting of House ballots continue. The markets have already responded with some volatility, with stocks rewarding the presumed likelihood of corporate tax cuts and perceiving a general penchant toward deregulation across industries as positive for earnings. On the other hand, bond markets have responded unfavourably, with yields rising on the prospect of a united front between executive and legislative arms of government with respect to fiscal expansion. This comes at a time when US debt-to-GDP is already at historic highs near 120% and budget deficits already exceed 6% of GDP.

In the near-term, the prospect of a Republican-controlled Congress and executive branch may increase the likelihood of Congress approving an increase in the US debt ceiling. Consistent with the latest Global Investment Committee’s outlook: low risk no longer, we remain constructive on US growth and therefore equity markets. Nonetheless, in the **longer-term**, a different scenario may unfold. We note that, to date, Congress has tended to raise the debt ceiling after some negotiation. As such the debt ceiling works more as an opportunity for Congress to enact checks on US fiscal health, an opportunity that is less likely to bear fruit when Congress is reluctant to challenge presidential fiscal proposals. Therefore, with the prospect of fewer hurdles to fiscal expansion and the possibility of sweeping tariffs on imported goods, we anticipate a **rise in tail risks associated with higher US inflation**. Additionally, **the bond market may experience potential disruptions** if external investors demand a higher premium to finance US external deficits.

We note that **dollar/yen** has appreciated on the prospect of a more aggressive US trade policy. Although this has helped bolster Japanese stocks, we see greater potential for interim volatility due to the narrow base of investors engaging in higher-frequency yen-funded carry trades. Additionally, the Bank of Japan (BOJ) remains on a tightening trajectory, and a weaker yen—feeding through via import prices to consumer prices—has been flagged as a more substantial inflationary risk at BOJ Governor Kazuo Ueda’s latest press release. Therefore**, a weaker yen, all else being equal, may bring forward the timing of BOJ rate hikes**, so long as market volatility has cooled down. For now, there is an environment of plentiful risk appetite, but given the rise in tail risks, we see some reason for those looking to hedge those lower-probability risks to hold at least a small proportion of their assets in yen. This is because should such tail risks materialise (such as a volatile disruption in US Treasury markets) , Japan’s current account surplus may suddenly appear more attractive than it does during times of higher risk appetite.

Lastly, it is important to focus on one aspect of the Trump vs. Harris race that had very little to do with their political platforms. Specifically, it will be a one term, rather than a two-term, presidency for Trump. Two-term presidencies typically bring greater negotiations (including fiscal negotiations) between the executive and legislative branches in the second term, which may increase the incentive for a candidate seeking re-election to curtail fiscal largesse. This incentive does not exist for a one-term candidate, which may mean that the **tail risks associated with fiscal profligacy may be larger** than for a two-term candidate. This could widen the divide between the short-term outcome (extending of the US economic cycle) and the impact of longer-term risks, such as disruption in the bond market.