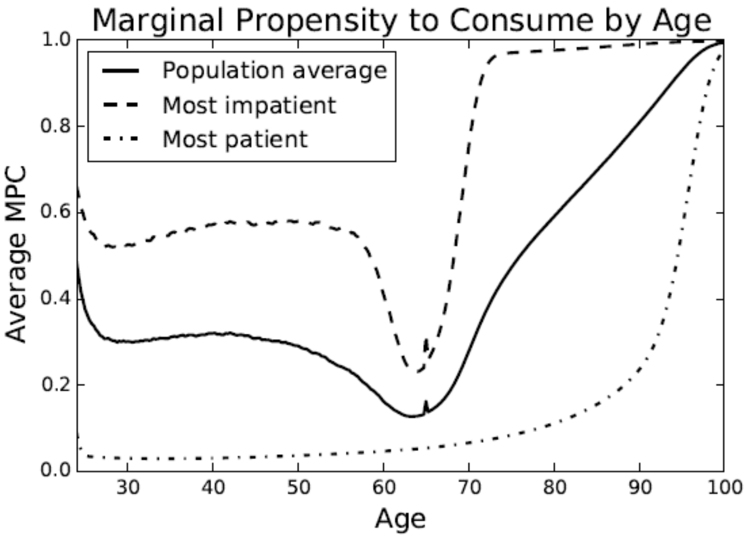
To what extent the Present Trump's fiscal policy will offset the Federal Reserve's increase in interest rates.

The contradiction between the Federal Reserve(Fed)'s attempts to increase interest rates and Present Trump's fiscal policy has been heatedly discussed. There is a widespread view that the Trump's fiscal policy will probably offset Fed's monetary policy. However, this article will show that Trump's fiscal policy may be able to offset Fed's attempts to raise interest rate in the short run but in the late "Trump era", the Fed may defeat Trump's expansionary fiscal policy.

Trump's fiscal policy generally consists of two parts – reductions on tax and an increase in expenditures. Currently, the fiscal policy is a large incentive to economy which Fed's policy temporary can't match. According to Trump's election website (*Tax Reform That Will Make America Great Again*, no date), Trump's tax plan will significantly reduce the tax by simplify tax code and reform business tax. As Zandi et al. (2016) estimate, this plan is likely to cause averagely 0.95 trillion tax loss. Although Zandi may not take the economic growth caused by Trump's fiscal policy into account, at least in a short period, it is still a useful estimation. In order to calculate the effect of Trump's tax plan, this article utilize Marginal Propensity to Consume(MPC) to measure the multiplier effect. The Figure 1 shows that the MPC of America is approximately 0.3 which means the tax multiplier is roughly 0.43. This indicates that the real effect of trump's tax may be about 0.41 trillion dollars. Compared to America GDP, this number seems to relatively small, but it makes a very strong incentive to the economy. Plus, although Trump's detailed expenditure is still unveiled, it may be clear that he will not take a contractionary expenditure policy because he has already promised to increase the spending of defense and welfare. Both Trump's tax and expenditure plan send a very clear message to the economy and currently the responds of the economy are also positive – the stock index roughly increase and America reach its lowest unemployment rate among last decades (Bureau of Labor Statistic, 2017). These factors show that Trump's fiscal policy, at present, is very effective.

Figure 1 Aggregate Marginal Propensity to Consume by Age (Carroll et al., 2016, p. 44)



The current Fed policy may not have this significant power as Trump's fiscal policy. An evidence may be the different responds of stock market to Fed's policy and Trump's policy. When Fed announced to raise interest rate, stock market didn't show a large contraction whereas when Trump won the election, stock market index indeed significantly increased. However, Fed's monetary policy has already influenced the bonds market and Janet Yellen, the Chair of Fed, seems to be very determined to control inflationary rate (Rennison, Platt and Bullock, 2017). Thus, it is expected that Yellen would render her policy more influential not only in bond market but also other economic sectors in the future. As Trump's fiscal policy seems to currently dominate the economy, Ms. Yellen will probably not choose directly contradictory and strong policy to against Trump. This hawkish Chair of Fed may choose to take actions in the near future to avoid direct contradiction with Trump. As examined above, although the current Fed's policy is probably not strong enough to defeat Trump's plan, in the future, it may have an opportunity to win.

Moreover, as Trump's expansionary fiscal policy gradually leads to an inflationary gap, people have more money and they also need to pay more tax. The loss of the tax may decrease and the withdraw effect may become larger. Moreover, since the economic growth faster, people get richer which may cause two results. One is the decrease in MPC for people don't have to spend most of their money to make a living. Another one is that people may save more, pushing the supply of loanable money to shift right. The first one may weaken the multiplier effect and the second may decrease interest rate which may encourage Fed to take stronger actions. As government expenditure and debt accumulate over time, the crowd out effect may be overweight to the multiplier effect. Therefore, the effects of Trump's policy are very likely to decline in the future unless he can persuade Congress to increase the national debt level to continue increasing expenditure. However, even if he can continue spending more, the demand of loanable money curve will also shift right due to accumulating governmental debt. At that time, since the Fed may further increase the interest rate, the monetary policy maybe gradually cause deep influence in the economy. Thus, overall, in the late "Trump era", it's very likely for Fed's policy to have larger influence on the economy.

In conclusion, this article supports the prediction that in a short period, Trump's fiscal policy is very probably to offset some effects of Fed's increase in interest rates but in the future, the situation could be opposite.

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