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GEOPOLITICAL STRATEGY

U.S. Politics & Policy Monitor: December 19, 2024

Trump, Tariffs & Taxes

***Note**: With the U.S. elections behind us, we are entering a pivotal period where policy and political shifts will significantly impact markets. While elections themselves moved markets, the subsequent government changes and policy shifts will be far more critical.*

To reflect this, our "U.S. Election Monitor" report, will transition into a "U.S. Politics & Policy Monitor." This updated publication will continue on an ad-hoc basis, analyzing the economic and market implications of the substantial political changes unfolding in Washington.

- The Trump administration is still deciding on its tariff approaches, though we expect pragmatism.
- On fiscal matters, Trump's fiscal spending will likely be far more restrained than expected.

Tariffs: Less Stringent Than Feared

The Trump administration will impose tariffs, though we expect those to be more moderate than the rhetoric indicates. A doubling of tariffs on China, and a universal tariff of 3-5% are plausible – these are significant, but still not as big as feared, and may avoid a massive tit-for-tat trade war. Such universal tariffs (with significant exemptions) would be considerably less disruptive than the much discussed 10-20% level.

Trade policy uncertainty, however, remains high as the Trump administration, still assembling its economic team, lacks a clear strategy. Three competing approaches are under consideration: universal tariffs to raise trillions over a decade, despite opposition due to potential economic disruptions; targeted tariffs to boost strategic industries and secure critical supply chains; and using tariffs as diplomatic leverage to open foreign markets, reduce trade barriers, and push for other foreign policy objectives.

A lively debate also surrounds whether tariffs should target allies or focus mainly on strategic rivals. Targeting allies like the EU, Japan, or Canada risks undermining coordinated efforts against China. We think heavier tariffs on China are likely, given the underlying geopolitical rivalry.

That said, tariff exemptions and targeted measures are likely, reflecting Trump's team's transactional, market-conscious approach. A deal with China is also eventually possible. Bottom line is, tariffs are likely to be less severe than now feared.

Finally, tariffs are unlikely to be inflationary. Historical evidence shows tariffs act as a tax, suppressing or shifting demand without driving inflation (**Chart 1**).

Trump's Initial Fiscal Policies Explained

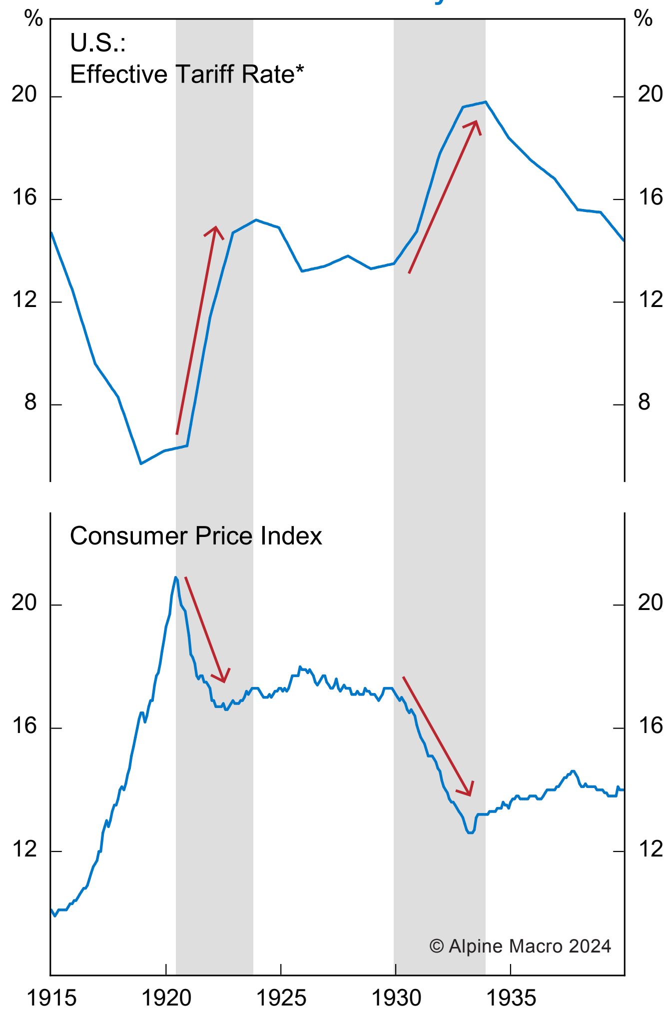
Last week, we highlighted an out-of-consensus view in our top risks for the year:[1] Trump's fiscal spending may be far less than expected, potentially even budget-neutral. While we don't anticipate immediate fiscal consolidation, a gradual reduction in deficit spending (over 5-10 years, towards 3%/GDP) is possible.

Some forecasts predict Trump will increase deficit spending by $5-10 trillion over ten years. We estimate a far lower range, $0-2 trillion, focusing on political feasibility rather looking at just what is proposed. Republicans in Congress lack the appetite for more than $2 trillion in unfunded spending over a decade. The 2017 Tax Cuts and Jobs Act (TCJA) cost $1.8 trillion and faced resistance even then. With a thin Republican House majority (1-3 seats), and numerous fiscal Republican hawks (40-80), passing a larger spending bill than that, on a partisan basis, seems implausible. This also assumes that Republicans manage to maintain their thin House majority, and no new membership changes/vacancies give Democrats control of the lower chamber.

Table 1 in the **Appendix** outlines our view, with key assumptions explained below. The largest likely outlay is making the 2017 TCJA provisions permanent, costing ~$4.6 trillion over ten years. This could be less, as some provisions, like restoring the SALT tax deduction, may not materialize due to opposition from non-blue-state Republicans who view it as a subsidy to high-taxing Democratic states.

1 Alpine Macro *Geopolitical Strategy* "Geopolitical Outlook 2025: Risks, Opportunities, And Surprises" (December 12, 2024).

Chart 1 Rising Tariffs And Protectionism Are Not Inflationary



*Total import duties collected as a % of total value of imports
Note: Shading denotes periods of rising tariff rates

Other spending initiatives could add ~$1.3 trillion over ten years, far lower than other estimates. For example, ending taxation of Social Security benefits, projected to cost over $1 trillion, is unlikely to pass due to budget reconciliation rules, which do not allow changes to mandatory spending programs like Social Security.

On the revenue side, we estimate $5.1 trillion in savings and revenue generation over a decade. This includes more modest tariff revenue ($1.3 trillion)[2] with most money coming from spending cuts, to programs like Medicaid, welfare, and student loans.

Significant savings could also come from reducing fraud and waste. A GAO report estimates federal fraud costs to be $233-521 billion annually[3], excluding waste and inefficiencies. Reducing fraud just by 20% of the lower estimate could save $500 billion over ten years. We think that the DOGE commission (staffed by competent leadership) will be able to work with the OMB to reduce such practices, by more than expected.

These numbers are highly tentative and carry a significant margin of error, but for now, we estimate $5.1 trillion in savings and revenue over ten years, resulting in an unpaid-for deficit of $1.4 trillion. This figure would be acceptable to Congress. Also, if welfare benefits to non-U.S. citizens were restricted (a legally fraught move) and if Fannie Mae and Freddie Mac were privatized (a longer-term process), the tax cuts and spending increases could effectively be offset.

Dan Alamariu
Chief Geopolitical Strategist

2 We are assuming tariffs will raise only roughly two thirds of the lowest revenue estimated by the Committee for a Responsible Federal Budget, U.S. Budget Watch 2024, "The Fiscal Impact of the Harris and Trump Campaign Plans" (October 28, 2024).

3 U.S. Government Accountability Office, "Fraud Risk Management", (April 2024).

Table 1 Trump's Fiscal Plans May Not Add Much To The Deficit, Could Be Deficit Reducing…

Policy Proposals	Assumed Cost ($Bn)	Rationale/Comments
TCJA - Individual Tax Permanence*	-3392.1	
TCJA - Restore Deduction of SALT Tax*	-346.7	Tax Foundation assumes a -$1.04tn cost, but this is unlikely to pass through Congress, unpaid-for. Could be $0. Alternative is that the cap may be raised by ~50%. We cut the cost in three, to account for political opposition
TCJA - Estate Tax Permanence*	-205.6	
TCJA - Business Taxes Permanence*	-643	
Exempt Overtime Income From Taxes	-250.0	Will be severely capped, by income, and by # of hrs worked , we expect half of the lowest CRFB scenario
End Taxation Of Social Security Benefits	0	Not doable through the budget reconciliation process
Exempt Tip Income From Taxes	-50	Will be severely capped to prevent obvious avenues for abuse (by income, etc). Expecting half of the lowest CRFB scenario.
Lower Corporate Tax Rate To 15% For Domestic Manufacturers*	-361.4	
Enact or Expand Other Individual And Small Business Tax Breaks	-200	CRFB central scenario (includes making auto loans tax deductible)
Strengthen And Modernize The Military	-400	Central CRFB scenario, assumes Mn$ spent per GDP stays constant
Secure The Border And Deport Unauthorized Immigrants	0	Lowest CRFB scenario. This will be likely paid-for
Enact Housing Reforms, Including Credits For First-Time Homebuyers	-50	Vague campaign promise, so assuming half the CRFB “Low” scenario
Boost Support For Health Care, Long-Term Care, And Caregiving	-25	Vague campaign promise, so assuming half the CRFB “Low” scenario
Subtotal, Tax Cuts And Spending Increases	**-5923.8**	
Establish A Universal Baseline Tariff And Additional Tariffs	1340	Assuming two thirds of the lowest CRFB scenario tariff revenues – assuming lower tariffs levels, import substitution, loopholes
Reverse Current Energy/Environment Policies And Expand Production	1021	Using the Tax Foundation $921bn in IRA subsidy cuts, plus the CRFB’s $200bn in other energy related policy gains
Reduce Waste, Fraud, And Abuse	500	DOGE and cutting government waste are as revenue raisers under-estimated, so taking the CRFB's highest number x2
End The Department Of Education And Support School Choice	50	Overestimated savings, assuming the CRFB’s “central” scenario, divided by 4
Reform Federal Employee Retirement**	237	
Roll Back Food Stamps Increases**	190	
Tighten Welfare Work Requiremens**	171	
End Food Stamp Categorical Eligibility**	112	
End Student Loan Forgiveness**	22	
Cap Federal Student Loans**	185	
Reduce ACA Tax Credit Abuse**	95	
Stop Medicaid Financing Gimmick**	500	
Block Grant Medicaid**	600	
Medicare Site-Neutral Payments**	100	

Stricter Limits For Bad Medical Debt**	23	
Subtotal, Revenue Increases And Spending Reductions	**5146**	
Net Interest From Additional Policies	-625	Average of "central" and "low" CRFB scenarios: spending will be on the low side
Total, Net Deficit Impact	**-1402.8**	Spending increase in line with the 2017 Tax Cuts Law (this is digestible for administration and Congressional fiscal hawks)
If these were to be included, the fiscal legislation would be close to deficit-neutral, or slightly reduce the deficit (Cato Inst)		
Restrict Welfare For Immigrants**	1300	Possible, but there are legal issues if this impacts legal immigrants
Privatize Fannie And Freddie Mac**	240	Challenging to pass through Congress, depending on the housing industry lobby power, FHA Director appointment
	1540	

*Tax Foundation "Donald Trump Tax Plan Ideas: Details and Analysis" (October 14, 2024)
**CATO Institute "Spending Cuts for 2025" (November 19, 2024)
Source: Committee for a Responsible Federal Budget, U.S. Budget Watch 2024, "The Fiscal Impact of the Harris and Trump Campaign Plans" (October 28, 2024)
These figures are highly tentative, and the confidence in them is low, as they will continue to change as fiscal plans are negotiated

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