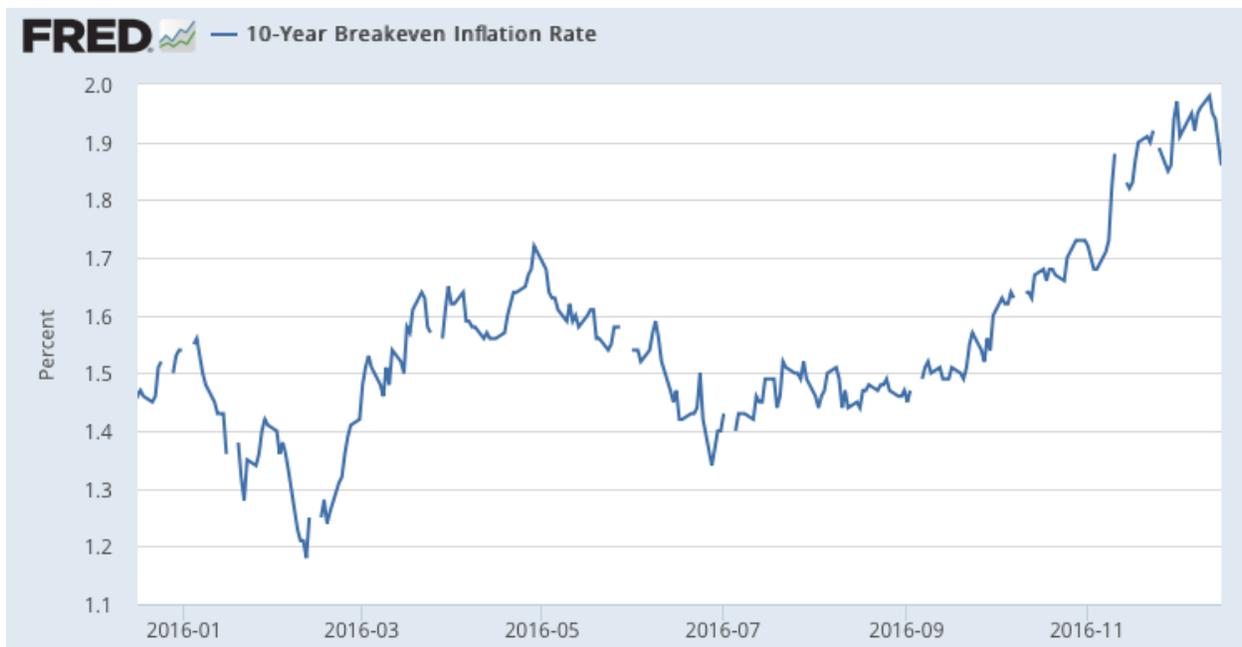


Are Markets Misreading Trumponomics?

Paul Krugman, 12/20/16

Financial markets seem to have decided that the Siberian candidate will pursue strongly expansionary macroeconomic policy. Long-term interest rates have risen sharply; expected inflation is also up, although not as much:



But are the markets getting this right? I suspect not: fiscal policy probably won't be expansionary as expected (or maybe at all), and Trump's economic team is looking like a gathering of goldbugs, who will if anything push for deflation.

On the fiscal side, I'm still seeing people talking about a huge infrastructure push. But there's no indication that Republicans in Congress are at all eager to get moving on this push; their priorities seem to be repealing Obamacare and tax cuts for the rich, perhaps especially the estate tax. And in any case what we know about that supposed infrastructure push is that it looks much more like a privatization scheme than an actual plan to boost public investment.

So what we're really looking at is a combination of tax cuts and spending cuts. Overall, this will surely increase budget deficits. But the tax cuts will go to the wealthy, who won't spend much of their windfall, while the spending cuts will fall on the poor and struggling workers, who will be forced into sharp cutbacks in spending. The overall effect on demand is therefore likely to be negative, not positive.

What about monetary policy? Well, that's set by an independent Federal Reserve – except that we're looking at a regime that doesn't care at all about institutional boundaries, or for that matter legality, so counting on Fed independence is foolish. And then we want to look at the personnel. Mnuchin, the Treasury pick, is a very secretive guy, but he's close to John Paulson, who has been warning about double-digit inflation from QE. Mulvaney, for OMB, spoke to the John Birch Society just a few months ago, declaring that the Fed has “effectively devalued the dollar”, and praising bitcoin as a currency governments can't manipulate. Kudlow, at CEA, was a big inflation hawk in 2009. Unusually – indeed, pretty much uniquely for this crew – he has admitted that he was wrong. But he surely hasn't changed his basic worldview, including rejection of demand-side economics of any kind.

Put this together, and you get a picture of a crew that isn't at all inclined to pursue the expansionary policies the market seems to be counting on. Now, as a political matter Trump really should engage in "reactionary Keynesianism" – big spending that benefits cronies, easy money to pump up the economy in the short run. But none of the people who will be advising him on macroeconomics thinks that way. Maybe the markets are getting this all wrong.