THE BEACON OUTLOOK
UNITED STATES

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WHAT DOES THE NEW ADMINISTRATION MEAN FOR THE CURRENT ECONOMIC EXPANSION?

REAL U.S. GDP GROWTH

Source: U.S. Bureau of Economic Analysis; Analysis by Beacon Economics.

Here we are at the start of 2025, with President-elect Donald Trump about to take office for a second term. For the second time, he is taking the helm of a nation that is already on a solid growth trajectory—one the Wall Street Journal called "The Envy of the World" just eight months ago. As 2024 drew to a close, the U.S. economy continued to beat expectations. Real GDP growth has averaged 3% over the past nine quarters, and preliminary data for the last quarter of 2024 suggests little change in that momentum, with growth expected to land in the mid-2% range. The big question is how Trump's win might change this trajectory.

The short answer is "not much," at least in the near term. Beacon Economics' optimism continues to stem from the strength of U.S. household finances. Despite ample rhetoric to the contrary, incomes have risen faster than inflation over the last five years. During this time, hourly earnings have grown by 4.8% annually , whereas consumer prices have risen 3.7% per year. Household debt-to-income ratios are falling, savings rates are running at a decent pace, and U.S. household net worth is at a record high.

And this isn't just an average. Although still high, income inequality is lower today than it was a decade ago. Workers in the bottom 50% of the earning pool have seen their incomes grow by 5.3%, compared to 4.4% growth for those in the top half. Wealth inequality is also down if we exclude the top 0.01% who skew the data. U.S. poverty rates are near all-time low levels. Given that consumer spending accounts for almost 70% of U.S. output, when American households do well, so does the rest of the U.S. economy, despite interest rate spikes. This is exactly why Beacon Economics rejected the recession calls that were so prevalent in 2023.

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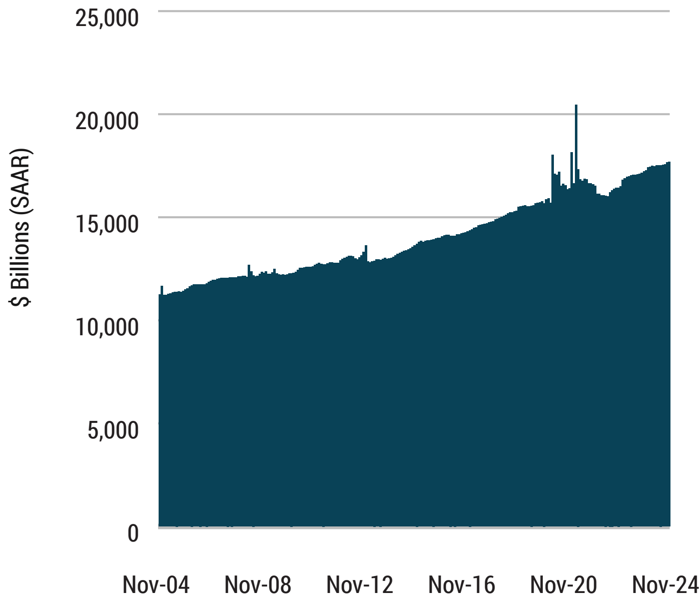
U.S. REAL DISPOSABLE PERSONAL INCOME



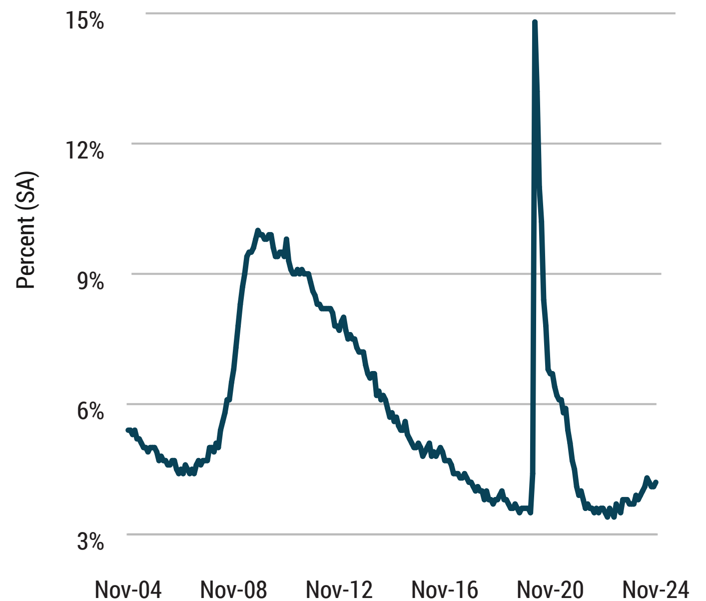
Source: U.S. Bureau of Economic Analysis. Analysis by Beacon Economics.

U.S. HOUESHOLD DEBT TO INCOME RATIO

Source: Board of Governors of the Federal Reserve System; Analysis by Beacon Economics.

The real risks of Trump's second term won't come from what he does but rather from what he doesn't do. This boils down to the fact that the U.S. economy looks as strong as it does right now because of two stimulative (and unsustainable) drivers: the yawning Federal deficit and sky-high asset prices. Neither of these trends can continue indefinitely, which implies the same for the strength of the current expansion. The big question before Trump's victory—and one that remains unanswered—is *when* these trends will revert to more sustainable levels and what impact that will have on economic growth. Trump's efforts will likely amplify today's growth trends in the short run, but only at the cost of intensifying the imbalances and making their eventual bust far more dangerous when it inevitably occurs.

U.S. UNEMPLOYMENT RATE



Source: U.S. Bureau of Labor Statistics; Analysis by Beacon Economics.

THE POLITICAL-ECONOMIC DICHOTOMY

Historically, during elections, a good economy typically favors the incumbent party; a stellar economy should practically guarantee a big win. Yet, despite the positive economic trends, the electorate was not happy in the lead-up to November's election. The University of Michigan's consumer sentiment index was running at 70-80, well below the 90-100 range typical during expansions. Gallup's economic confidence index remained far below where it was prior to the pandemic.[1] In the end, the election swung solidly to the Republicans, who gained control of the White House and Senate while maintaining control of the House.

1 https://news.gallup.com/poll/652250/majority-americans-feel-worse-off-four-years-ago.aspx

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As Beacon Economics noted in a **recent commentary**, what's particularly interesting about Trump's big win in 2024 is that it was a protest vote—with very little to protest. Specifically, it was a protest against inflation, which has played, and continues to play, a large role in any conversation about the U.S. economy despite the fact that it was driven by excess consumer demand, has largely subsided, and the nation's economy has continued to grow regardless. Yet, the social narrative regarding inflation trumped reality. As it turned out, Chairman Jerome Powell's Federal Reserve and its excessive reaction to the pandemic that drove the nation's bout of inflation, became Trump's ace in the hole.[2]

Of course, inaccurately dismal views of the economy long predate Trump. Even before his first win in 2016, a steady drum beat of 'miserabilism' was a defining feature of much economic commentary. The Democrats, while bemoaning how voters ignored statistics showing the obvious health of the economy, have themselves have been front and center in terms of spreading the 'miserabilist' narrative that has so deeply infected the national psyche. Trump didn't invent miserabilism—he just used it, and very effectively, to achieve his political ends. A hopeful view is that once in office, Trump will acknowledge the strength of the U.S. economy and focus on other pursuits, but don't bet on it. He will almost certainly test the guardrails of the presidency in his second term, as he did in his first.

On the other hand, the forecast "game du jour" is to take Trump's various economic policy threats during the campaign at face value and attempt to predict their impact. The problem is that one can never take Trump at face value—this is, after all, the same man who made over 30,000 false or misleading claims during his first term.[3] His current threats sound like amplified versions of what we heard leading up to 2016: in 2024, Trump threatened tariffs of 25% across the board, whereas in 2016, he floated a 10% across-the-board tax.[4] As President, he did ultimately impose some tariffs on a limited selection of products, but never came close to his initial threats.

This time, these moves will be heavily influenced by a cluster of billionaires who have become part of his inner circle. Elon Musk clearly has the President's ear (at least for now), and Musk, for one, could surely do without a major trade war given the global supply chains involved with his many businesses. Scott Bessent and Howard Lutnick have also been appointed to important government positions, and as members of the finance industry, they will have little interest in rocking the economic boat. All of this suggests that Trump will be held back—at least at the start—from some of his worst tendencies. How this dynamic morphs over time, however, is very difficult to predict. We really don't have any idea what he will actually do once back in power, and some of his efforts are likely to be stimulating, at least in the short run. Ergo—expect growth to continue.

THE RISKS OF DOING NOTHING

The real risks of Trump's second term lie in what he doesn't do—tackle the Federal deficit and the nation's growing asset bubble. The current Federal debt-to-GDP ratio stands at 120%, higher than that of any developed nation except Japan and Italy. And over the last two years of the Biden administration, the national deficit has widened to roughly 7% of GDP. Current estimates from the Congressional Budget Office project no near-term narrowing of the deficit because of increased spending on entitlements, and the insolvency dates for both Social Security and Medicare have been moved forward.[5] Clearly, dealing with the deficit should be a central focus of any new administration—and just as clearly, it won't be.[6]

Trump's first term in office saw a sharp increase in the pace of Federal borrowing, from 3% of GDP to 5% just prior to the onset of the pandemic. One of his top priorities in the coming year will surely be extending the tax cuts he enacted in 2017,

2 Donald Trump's 2016 victory was actually far more surprising than his 2024 one, given how the economy and consumer confidence had improved over the last four years of the Obama administration.

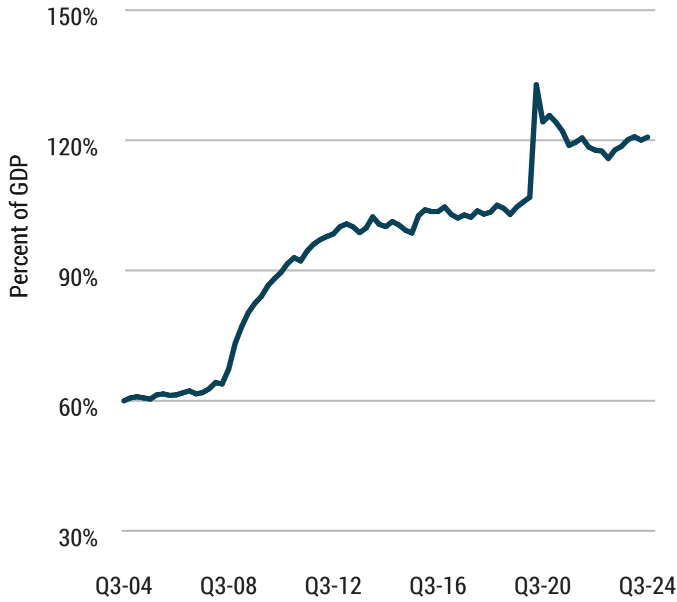
3 https://www.washingtonpost.com/politics/2021/01/24/trumps-false-or-misleading-claims-total-30573-over-four-years/ Please don't take this as a pejorative—I dare say that a large portion of his base wouldn't disagree with this observation. They would only disagree that such behavior is necessarily a bad thing in the rough and tumble world of realpolitik.

4 https://www.cnn.com/2016/12/21/politics/donald-trump-tariffs/index.html

5 https://www.cbo.gov/publication/60419

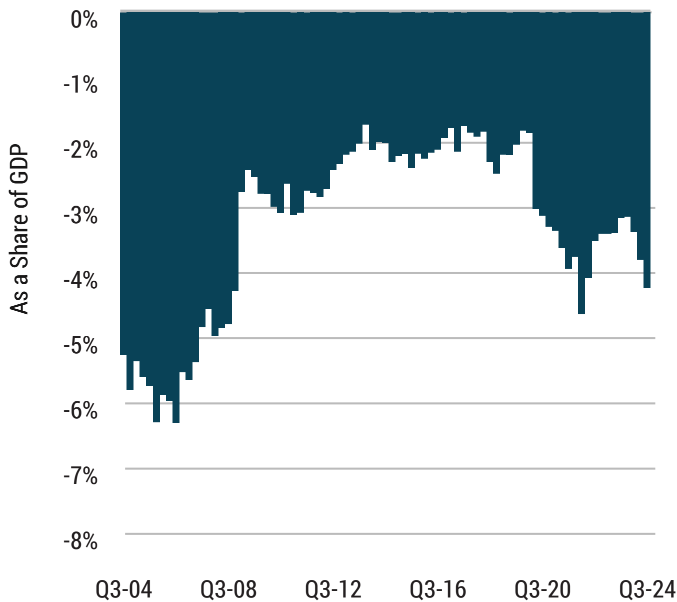
6 To be fair, it seems highly unlikely that a Harris administration would be much better on this front.

U.S. FEDERAL DEBT AS A % OF GDP



Source: U.S. Office of Management and Budget; Analysis by Beacon Economics.

CURRENT ACCOUNT BALANCE AS % OF GDP



Source: U.S. Bureau of Economic Analysis; Analysis by Beacon Economics.

which are set to expire at the end of 2025. Trump has also promised cuts in Federal spending, guided by Musk and Vivek Ramaswamy through their so-called Department of Government Efficiency (DOGE). But realistically, this is little more than a red herring. After all, it is Congress that controls spending, and while lawmakers are happy to support spending cuts in principle, they rarely do when it comes to specific line items.

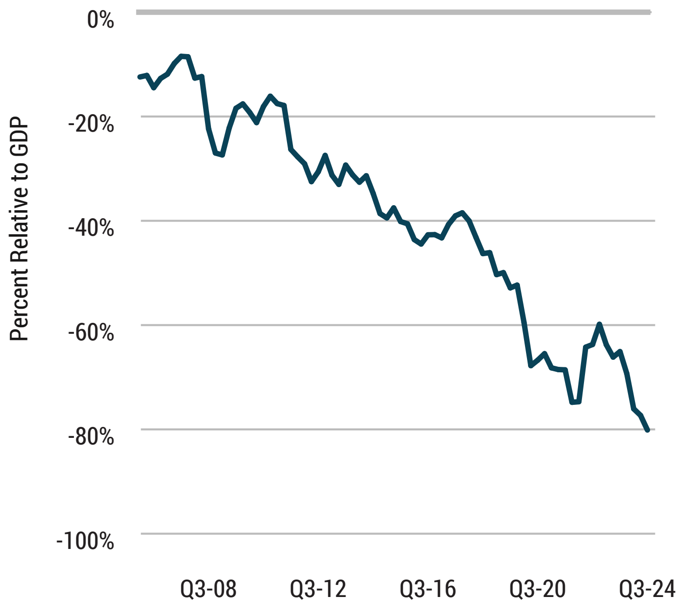
With household savings rates insufficient to cover the deficit, the United States has become ever more reliant on global investors to make ends meet. The nation's current account deficit is widening again, hitting -4% of GDP in the third quarter of last year. The only extended period where the United States borrowed this much from the rest of the world occurred in the run-up to the Great Recession—an ominous parallel. However, there is a major difference between then and now: in 2006, the U.S. net international investment position (the value of U.S.-owned assets abroad minus foreign ownership of assets in the U.S.) was -12% of GDP, whereas it currently stands at -77% of GDP.

In short, the United States has been on a massive borrowing spree, raising questions about when lenders might start to worry about being repaid. For now, foreign investors seem to be oblivious to these growing risks, as evidenced by the strong value of the dollar despite the trends. Some of this may be attributed to the nation's status as a safe haven for global investors. More likely, however, investors are bringing their dollars to the United States, not to buy government securities but rather to buy equities—which have seen some astonishing gains over the past five years—as well as other liquid assets like cryptocurrencies. The U.S. asset bubble has become a global phenomenon.

Calling a bubble is always risky business. When can we truly say that assets are overvalued given the vagaries of future outcomes? That said—this is clearly a bubble. Consider that from 2014 to 2024, corporate profits as a share of GDP grew modestly from 8.2% to 10.2%, while stock market capitalization soared from 115% of GDP to over 200%.[7] Shiller's CAPE (cyclically adjusted price-to-earnings) ratio hit its second highest level ever in November 2024, surpassed only by October 1999. And let's not forget crypto, where Bitcoin recently crossed over the $100,000 mark. Its P/E ratio? Infinity—because there are *no earnings*, yet another reason to question its intrinsic value.

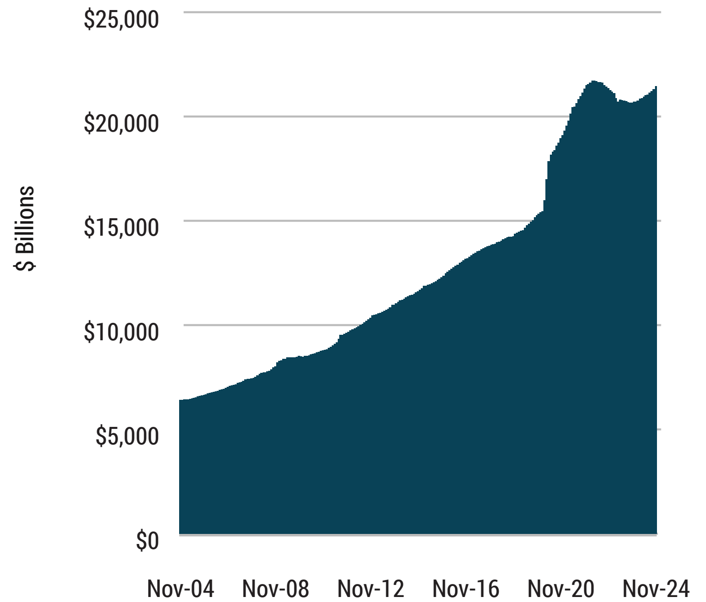
7 https://www.gurufocus.com/economic_indicators/4602/usa-ratio-of-total-market-cap-over-gdp

U.S. NET INTERNATIONAL INVESTMENT POSITION



Source: U.S. Bureau of Economic Analysis; Analysis by Beacon Economics.

M2 MONEY SUPPLY



Board of Governors of the Federal Reserve System; Analysis by Beacon Economics.

How will the new administration deal with the asset bubble? Probably not at all. Trump has already made it clear that he plans to rein in regulators. This, combined with an easing Federal Reserve, is likely to cause asset prices to continue their path "to the moon" in the near term. But what goes up must come down. These unsustainable trends have to revert at some point in the future, crashing back to earth like some defective satellite.

FED POLICY, THE NEW ADMINISTRATION, AND HOW IT WILL UNWIND

Where is the Federal Reserve in all of this? Inflation has cooled, with the October PCE deflator up just 2.3% over the past year. Given the lofty P/E ratios, one might expect the Fed to continue tightening monetary policy rather than loosening it—as the old saying goes, the Fed's job is to take away the punch bowl before the party really gets going. But tight credit throughout 2023 and much of 2024 did not affect the financial bubble at all. Meanwhile, banks and real estate markets have struggled under the weight of the rate hikes and the inverted yield curve. And so, in response, the Fed has started loosening, cutting rates by 100 basis points so far—and promising more next year, albeit at a slower pace. Credit conditions are still tight but are loosening, at least for now.[8]

Still, the news isn't as good as it might seem—the Fed has continued quantitative tightening, reducing its balance

8 https://fred.stlouisfed.org/series/SUBLPDRCSC , https://fred.stlouisfed.org/series/DRTSCILM

PERSONAL CONSUMPTION EXPENDITURES PRICE INDEX

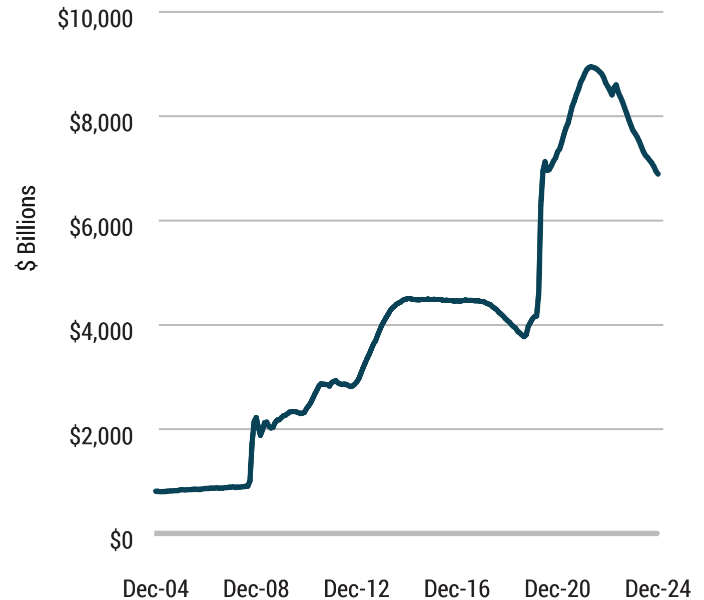
Source: U.S. Bureau of Economic Analysiss; Analysis by Beacon Economics.

sheet by $60 to $95 billion per month. This is constraining money supply growth and has driven the bounce back in the 10-year bond rate since rate cuts began. These actions seem to be about unwinding the yield curve, not stimulating the economy. Perhaps the Fed is hoping that a tighter money supply will succeed in constraining asset prices where higher short-term rates have failed.

So, with the Fed on the sidelines and the new administration unlikely to tighten the nation's fiscal belt, expect the U.S. economy to continue on its current growth trajectory in the short term. But all parties come to an end. The big question is whether the inevitable bust will happen before Trump leaves office—spoiling the latter part of his second term as the pandemic derailed the first—or if he will manage to exit before it hits, leaving the cleanup for the next administration.

How it will unravel seems clear: when financial markets turn, foreign investment will dry up, the dollar will weaken, and interest rates will spike yet again. The impact on the rest of the economy will depend critically on two factors: the extent of the imbalances that have accumulated and the speed of reversion when it finally happens. For now, the new administration will likely keep the economy growing well for the next couple of years by prolonging these imbalances—but at the cost of intensifying the inevitable bust.

FEDERAL RESERVE ASSETS



Board of Governors of the Federal Reserve System; Analysis by Beacon Economics.

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UNITED STATES FORECAST

U.S. FORECAST - OUTPUT

	Current	Forecast			
	Q3-24	Q4-24F	Q1-25F	Q2-25F	Q3-25F
Real GDP (Billions, 2012$)	**23,386.2**	23540.1	23,675.2	23,833.7	23,984.5
Real GDP (% Change from Preceding Period, SAAR)	**2.8**	2.3	2.7	2.7	2.6
Consumer Spending (Billions, 2012$)	**16,111.7**	16,230.9	16,351.3	16,472.7	16,596.4
Consumer Spending (% Change from Preceding Period, SAAR)	**3.7**	3.0	3.0	3.0	3.0
Nonresidential Investment	**4,270.0**	4,316.2	4,364.9	4,421.7	4,484.8
Nonresidential Investment (% Change from Preceding Period, SAAR)	**1.4**	4.4	4.6	5.3	5.8
Fixed Investment (Billions, 2012$)	**3,532.8**	3,560.9	3,603.0	3,652.4	3,708.9
Fixed Investment (% Change from Preceding Period, SAAR)	**3.3**	3.2	4.8	5.6	6.3
Change in Private Inventories (Billions, 2012$)	**784.7**	789.0	797.6	805.5	811.9
Government Spending (Billions, 2012$)	**-5.2**	2.2	4.4	4.1	3.2
Government Spending (% Change from Preceding Period, SAAR)	**60.2**	93.7	127.4	162.0	174.9
Net Exports (Billions, 2012$)	**3,965.5**	3,977.9	3,987.9	3,995.1	4,005.8
Net Exports (% Change from Preceding Period, SAAR)	**5.0**	1.3	1.0	0.7	1.1
Exports (Billions, 2012$)	**2,634.0**	2,659.7	2,683.8	2,710.9	2,740.5
Exports (% Change from Preceding Period, SAAR)	**8.9**	4.0	3.7	4.1	4.4
Imports (Billions, 2012$)	**3,711.1**	3,777.7	3,852.8	3,938.2	4,025.1
Imports (% Change from Preceding Period, SAAR)	**11.2**	7.4	8.2	9.2	9.1

Source: U.S. Bureau of Economic Analysis; Forecast by Beacon Economics

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U.S. FORECAST - KEY INDICATORS

	Current	Forecast			
	Q3-24	Q4-24F	Q1-25F	Q2-25F	Q3-25F
Industrial Production (index)	**102.7**	103.3	104	104.7	105.4
Total Nonfarm (Quarterly Change, 000s)	**421**	505.5	555.9	522.4	459
Unemployment Rate (%)	**4.2**	4.3	4.3	4.3	4.2

Source: U.S. Bureau of Economic Analysis, California Employment Development Department, U.S. Census Bureau; Forecast by Beacon Economics

U.S. FORECAST - INFLATION

	Current	Forecast			
	Q3-24	Q4-24F	Q1-25F	Q2-25F	Q2-25F
Consumer Price Index (% Change, Year-over-Year)	2.6	2.5	2.3	2.2	2.4

Source: U.S. Bureau of Labor Statistics; Forecast by Beacon Economics

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