Americans Are Not Better Off under Donald Trump and the Republicans

Robert Shapiro, September 2018

Part 1: An Overview of the Economy

The U.S. economy is in the late stages of the long expansion put in place by the policies of Barack Obama and the Democratic Congress. Since 2017, the policies of Donald Trump and the Republican Congress have weakened the economic prospects of most Americans. The GOP tax cuts have provided a short-term stimulus that will generate a short period of healthy economic numbers. But the tax cuts have not altered the shape and path of the current business cycle: The United States is headed for a downturn. The Republicans regularly tout what they call strong economic data, including the . But in real terms – adjusted for inflation – incomes and housing construction are falling, consumer spending is slowing, and even the gains in employment over the Trump's first 18 months are substantially less than the gains over the last 18 months of the Obama administration. (Part 2 of this memo provides those particulars.)

Democrats this fall should highlight Trump's economic failures. Americans know from first-hand experience that their wages and salaries are not keeping up with inflation and that their spending covers them fewer goods and services. Moreover, based on the data and other evidence, including the impact of the GOP's vast increases in budget deficits and billions of dollars in new tariffs, the economy is likely to enter a recession in 2019 or early 2020. Further, the growing crisis over the competence, corruption and chaos of the Trump administration and GOP Congress is affecting investors' confidence in the U.S. economy, which could accelerate the onset of the downturn. Attacking Trump's economics this Fall will help insulate Democrats when he and the GOP try to blame the recession on our control of one or both houses of Congress.

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The economic stimulus and reforms put in place by President Obama and the Democratic Congress in 2009 reversed the economy's dangerous descent towards a deep Depression and laid the foundation for the recovery that began in late 2009 and for current, prolonged expansion. This expansion has lasted for more than nine years, longer than any other except the 1990s boom under Bill Clinton. In the final years of an extended expansion, job creation, income gains, consumer purchases and housing investment all tend to slow down. Part 2 of this memorandum documents the extent of their slowdown or actual declines under Trump.

Trump and the GOP Congress have rejected options such as a major infrastructure initiative or largescale student loan forgiveness, which could have further extended the expansion. Instead, Trump and the GOP Congress shifted course on taxes and trade in ways that have weakened the economic prospects of most Americans. In tax policy, their $1.5 trillion tax cuts went overwhelmingly to profitable businesses and their wealthy shareholders. These tax cuts received *no* support from Democrats in Congress, because they provided virtually no benefits for average households, added trillions of dollars to budget deficits, and even failed to stimulate additional significant business investment.

The largest effect of these GOP tax changes, coupled with Trump's large increases in defense spending, has been to reverse the progress on budget deficits achieved under President Obama. According to the Congressional Budget Office (CBO),[1]

- Under Obama, the budget deficit declined from $1,413 billion in 2009 or 9.9% of GDP, to $438 billion in 2015 or 2.4 % of GDP;

- Under Trump and the GOP, the 2018 deficit will reach $804 billion or 4.0% of GDP;

- Under their policies, CBO projects deficits of $1,008 billion by 2020 or 4.5% of GDP, and $1,224 billion in 2024 or 4.8% of GDP.

The business tax cuts driving these sharply rising deficits have produced a temporary "sugar high" stimulus evident in the jump in GDP growth in the second quarter. Most companies have used their large tax savings tax not to increase investment, salaries or jobs, but mainly to buy back their stock and thus enrich their executives and other shareholders. As a result, this stimulus will be short-lived, and GDP growth will slow very substantially by the fourth quarter. Moreover, the growing deficits have forced the Federal Reserve to increase interest rates, which in turn have already begun to slow consumer spending and housing investment.

Trump's unilateral decision to impose billions of dollars in new tariffs on hundreds of products exported to the US by major trading partners also will damage economic prospects for many Americans. As expected, the trading partners targeted by Trump are retaliating with new tariffs on hundreds of products exported by U.S. manufacturers and farmers. The result is rising prices for U.S. consumers and falling exports by U.S. companies. The Census Bureau reports that in the first two month retaliatory tariffs were in place, June and July of this year, U.S. exports fell 0.7% and 1.0%, only the second time in nearly two years that exports declined over two successive months.[2] Further, the conservative Tax Foundation estimates that the tariffs already enacted or announced, here and abroad, will cost Americans $151 billion in GDP and 467,373 jobs.[3]

Finally, the corruption and other transgressions that have triggered the deepening criminal investigations of Trump and his campaign, businesses and administration will also hasten a recession. When a serious political crisis leads domestic and global investors to begin to doubt an administration basic capacity to respond appropriately to events, their confidence in the American economy weakens, and their investment sin that economy falter. That is precisely what happened during Nixon's crisis. The economy was weakening, and the growing investigation of his lawlessness helped push the economy into a downturn that started in November 1973, deepened throughout 1974, and lasted until March 1975.

Many Americans have begun to feel the costs of the economic weakening aggravated by Trump's policies – many more will feel them soon -- and those costs will rise sharply when this weakening economy falls into recession. For economists, the clearest signal that the economy is

[1] Congressional Budget Office (2018). "Budget and Economic Data." https://www.cbo.gov/about/products/budget-economic-data#2.

[2] U.S. Census Bureau (2018). "Monthly U.S. International Trade in Goods and Services, June 2018." https://www.census.gov/foreign-trade/Press-Release/current_press_release/ft900.pdf; "Monthly U.S. International Trade in Goods and Services, June 2018." https://www.bea.gov/system/files/2018-09/trad0718.pdf .

[3] Tax Foundation (2018). Tracking the Economic Impact of U.S. and Retaliatory Tariffs." August 28, 2018. https://taxfoundation.org/tracker-economic-impact-tariffs/

weakening and headed for recession under Trump and the Republicans comes from recent changes in interest rates and their effect on the shape of the "yield curve."

The yield curve tracks the returns on all Treasury securities based on their term or original period to maturity. When the economy is strong, investors can feel very confident that any short-term investments will work out – so, demand for 6-month, 1-year or 2-year Treasury bills or notes rises, which in turn lowers the yields or returns that the Treasury has to offer investors to buy them. Those investors have less confidence about longer-term investments, since the future in unknown. Weaker demand for 10-year, 20-year and 30-year bonds forces the Treasury to offer higher returns to get investors to buy them, so the yield curve slopes upward as the securities' terms rise.

When the economic outlook darkens, however, investors' confidence in the short term weakens. As a result, demand for short-term securities weakens, and the government has to offer investors higher returns on those short-term securities. This produces what economists call a "flattening of the yield curve" – short-term yields move to converge with long-term yields – which is the most reliable sign of a coming recession. As a recession comes closer, the yield curve often becomes "inverted," which means that the Treasury has to offer higher returns to sell short-term securities than they do to sell longer-term securities.

However much the Republicans try to talk up their economic record, the yield curve has become almost flat since Donald Trump took office. This is the best indicator economists have that a recession has become foreseeable. The evidence: Compare the yields on short term and long term Treasury securities on January 20, 2017 when Trump took office, with the latest report on those yields (August 31, 2018).[4]

- The yield on 6-month securities rose from 0.62% on January 20, 2017 to 2.28% on August 31, 2018, while the yield on 10-year securities only moved from 2.48% to 2.86%. As a result, the yield curve flattened from a gap of 186 basis points (bps) to a gap of 58 bps;

- Over the same period, the yield on 1-year securities rose from 0.82% to 2.46% while the yield on 20-year securities only moved from 2.79% to 2.95%. As a result, the yield curve flattened from a gap of 197 bps to a gap of 49 bps; and

- Over the same period, the yield on 2-year securities rose from 1.20% to 2.62% while the yield on 30-year securities fell from 3.05% to 3.02%. As a result, the yield curve flattened from a gap of 185 bps to a gap of 40 bps.

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The economy has weakened steadily during Trump's time in office, mainly as a result of the reckless policies of his administration and Republicans in Congress. Instead of taking steps to support average families, they slashed taxes for big businesses and ignited a protectionist war over tariffs. This economic deterioration is clear in the data on wages and salaries, job creation, consumer spending and housing investment, all presented in Part 2 of this memorandum. These trends, along with the impact of Trump political crisis, all suggest that a recession is now likely within twelve to 18 months.

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[4] U.S. Treasury (2018). "Daily Treasury Yield Curve Rates." https://www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/TextView.aspx?data=yield.