MAKING AMERICA GREAT (BREAK) AGAIN

"In Politics Nothing Happens By Accident. If It Happens, You Can Bet It Was Planned That Way" – by Franklin D Roosevelt 32nd President of United States of America

The quote seems to hold true for current US President Mr. Donald Trump who got elected on the promise of no cuts to Social Security, Medicare & Medicaid. The voters who got him elected may feel betrayed when they see the president's first proposed budget for 2018. Repealing Obamacare, Budget cuts in Environmental protection agency (31.4%), proposed cuts in State & International aid (29.1%), Labour (19.8%), Education (13.5%), Transportation (12.7%), proposals to eliminate or cut many other govt. programs, reduction in tax rates and increase in defence spending are some of the major highlights of Trump's Budget proposals. While the aim is to make America great again, we in this note try to access the likely impact of newly proposed fiscal budget 2018 on US GDP, increasing US debt and its likely impact on US dollar.

TRUMP'S BUDGET PROPOSAL:

Obama's Legacy has left American economy with ~$20 trillion of outstanding debt and more than $550 billion plus of annual budget deficit. What's more perplexing is the newly elected president aims to turnaround the situation and achieve fiscal surplus by 2027 after $3.6 trillion in spending reductions and $2.1 trillion in economic growth-induced revenue increases. These numbers are arrived based on some unrealistic growth assumption, unachievable spending cuts and some phantom tax increases with no clarity on tax details. Although the budget has negligible chance of passing it through congress, it reinforces Mr Trump's move away from the promises of his campaign to avoid making hard choices that would be needed to get anywhere near a balanced budget. The budget which promises to be in balance by 2027, would in reality continue to remain in dark red during the period and eventually add trillions of dollars to national debt – How?

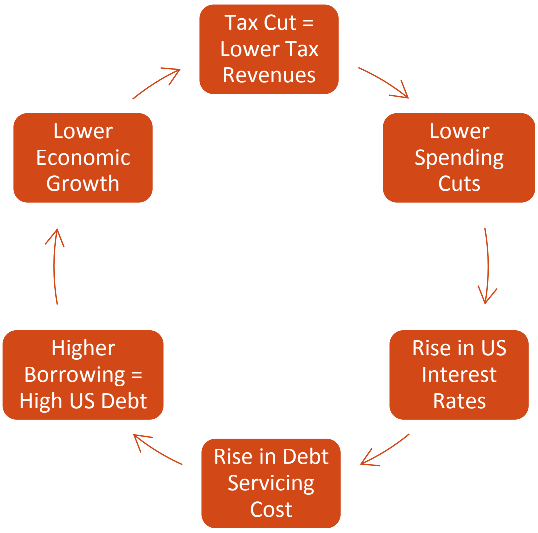
Year	Budget Deficit^	Total US Debt*
2005	-321.78	7910.75
2006	-209.22	8416.21
2007	-187.94	8909.89
2008	-680.47	9704.21
2009	-1471.30	11449.74
2010	-1275.10	13130.42
2011	-1249.57	14498.79
2012	-1060.76	15827.57
2013	-559.51	16793.79
2014	-487.71	17634.09
2015	-477.97	18239.74
2016	**-580.06**	19383.24
2017	-134.59	**19884.51**

*^Fig. in Billion US Dollar; *Fig. in '000 Billion US Dollar*

As British Economist John Maynard Keynes said, 'In long-run, we are all dead' but till the time we are alive the proposed budget is likely to inflict pain in short-term. While, the Trump administration proclaims that the business investment and worker productivity would increase considerably, which would eventually lead to high economic growth, seems to be a flawed argument. The enormous spending cuts proposed would make increasing efficiency (productivity) harder and not easier. The Trump administration also forecast real GDP rate to be 3% by 2021 and continue to remain above that level for years. As basic economics teaches us, **"aging population and falling productivity would only hinder GDP growth"**. The only way to increase the size of labour force and improve productivity is to allow more '**immigration**' – but that would result in complete deviation from Trump's election agenda. Also, the proposed tax cuts (both Individual to 35% and Corporate tax to 15%) fail to explain how the administration would offset the revenue loss. If the tax cuts are not financed by huge spending cuts, which in this case looks difficult for cuts to be approved by US Congress, the tax cuts will lead to increase in federal borrowing which in turn will reduce the long-term economic growth. Hence the economic growth-induced revenue increases will be hard to come by.

DEBT BOMB:

US certainly is not in the middle of debt crisis right now - as much of the debt is held internally. Despite this fact, it is sensible to aim for lower debt in the coming years, reason being there is no guarantee that the growth rate of the economy continues to remain higher (3% & above). With expected fall in tax revenues due to tax cuts and rise in federal interest rates the rise in debt servicing cost would only add to the overall debt burden. High debt levels tend to have long-run cost impact in form of reduce national savings, burdening future generation with external debt, reduce capital formation and ever growing debt to GDP ratio. Once the govt. becomes addicted to borrowing, it is tough to get rid of the habit.



The debt financing is done by issuance of Long, Medium and Short-dated debt bonds to sell. In the low interest rate environment, many argue that govt. should sell proportionately more long-dated bonds to make sure they can pay historically low rates for many decades to come – thereby saving taxpayers money in the long run. Some countries have resorted to the idea of issuing **'Ultra-Long Bonds'** 50 -year and 100-year bonds. US is also flirting with this idea of issuing ultra-long bonds with long term interest rates at historic lows. But short-term rates are even lower which means selling longer-dated debt will raise the overall cost. Therefore, the issuance of ultra-long bonds would depend on future inflation and growth. Higher levels of each would probably push up the short and medium term interest rates. Hence, ultra-long bonds would be cost-effective in the long run only if short and medium-term interest rates exceeds the levels of long-term rates today, if not so, it will only add burden on the govt. in form of high debt servicing cost.

DOLLAR OUTLOOK: WATCH OUT FOR THE MONTH OF SEPT.17:

Mr. Trump's proposed cuts to Medicaid and Non-defence discretionary spending, lawmakers are unlikely to agree on a fiscal 2018 budget. Congress must reach some deal before 30th Sept 2017, else there is possibility of U.S. government shutdown from 1st Oct.2017. The last govt. shutdown was observed in 2013 during Obama presidency which lasted for 16-day-long when the two chambers of Congress failed to agree on a bill to be signed into law. Historically it has been evident, whenever there has been **US govt. shutdown** the uncertainty over passing the bill by the Congress resulted in **'weakening of US Dollar'** and huge volatility in currency market. We believe the aggressive budget cuts proposed by Trump administration is likely to face govt. lockdown situation if congress fails to reach some agreement on funding by 30th Sept. 2017. Any such sign of probable govt. shutdown will be witnessed by weak US dollar thereby impacting the dollar denominated commodities positively. Commodity prices are likely to rise and remain volatile in and around Sept.2017 till the interim bill is agreed upon and signed into law.

'BE WATCHFUL'