



MORNING BRIEFING

December 14, 2016

Fiscal Spending in Trump World

(1) Don the Builder's \$1 trillion infrastructure stimulus pledge. (2) Could fiscal boost be too much, too late? (3) In Trump World, it's the goal that matters. (4) Wilbur Ross likes tax credits and other incentives to lure private funding. (5) A plan to entice companies to use offshore cash stash for domestic infrastructure. (6) Are there enough workers to fill new fiscally created jobs? (7) Stimulus target is idle army of NEETs. (8) Both wages and productivity might get a boost. (9) Yellen is waiting on Trump.

Trump World: Ready To Shovel. President-elect Donald Trump is aiming to boost US economic growth by aggressively lowering taxes and increasing government spending. Another fiscal kick is expected to come from Trump's efforts to deregulate lots of industries. Last week, Melissa and I discussed Trump's proposals for reducing corporate taxes. We concluded that the cut in the effective rate might not be as great as the cut in the statutory rate, though it will still boost corporate earnings significantly, as Joe and I discussed yesterday. Today, we come to a similar conclusion about Trump's infrastructure investment promises.

The media headlines suggest that Trump will increase infrastructure investment by \$1 trillion over the next 10 years. However, that eye-popping figure is the goal of the stimulus, not the actual amount of government spending. Funding for much of the targeted investments isn't likely to come directly from the federal government, but rather from tax credits and other incentives. By the math laid out below, the actual cost to the federal government will be far less than \$1 trillion, and even might be revenue-neutral.

Trump shouldn't have too much trouble reaching the seemingly lofty \$1 trillion goal because the expected total stimulus from his program--including investment and tax incentives, and deregulation components--will make it hard to determine the amounts of stimulus created from each; it seems there will be plenty of overlap. For example, as we discussed in our 12/5 [Morning Briefing](#), corporations (possibly just manufacturers) might be granted the option of electing 100% up-front tax deductions for investments in equipment and structures, as opposed to depreciation over years--a potential boon to infrastructure investment spending (assuming that factories are defined as "infrastructure," of course).

In any event, executing fiscal-spending plans as bold as the \$1 trillion advertised could be stymied by a lack of laborers in a US economy that appears to be very close to full employment. Spending that bold could cause inflation to overheat. On the other hand, in the current environment, wages may still have some room to run and productivity growth might improve.

Our bottom line is that Trump's fiscal punch might be more like a shove. It might be just enough to propel the US economy out of its slow-growth trap without causing it to overheat. Furthermore, the targeted nature of Trump's plans seems to be aimed right at the industries and workers that need it most. Industrial companies like US Steel already are declaring their enthusiasm for the expected regulatory breaks and tax windfalls under Trump, per CNBC's 12/8 [interview](#) with the company's CEO. Consider the following:

(1) *Privately funded.* Trump's pre-election 10/22 [100-day action plan](#) doesn't tie any specific dollar amounts directly to federal spending. It states that that the administration will fight for the passage of

the American Energy and Infrastructure Act, which “leverages public-private partnerships, and private investments through tax incentives, to spur \$1 trillion in infrastructure investment over ten years. It is revenue neutral.”

Further, the sixth out of the seven actions to protect the American worker is to “lift the Obama-Clinton roadblocks and allow vital energy infrastructure projects, like the Keystone Pipeline, to move forward.” The seventh is to “cancel billions in payments to U.N. climate change programs and use the money to fix America’s water and environmental infrastructure.” Neither mentions the use of federal dollars.

No specific mention of federal dollars to be used is made on the “Energy Independence” section of the “Great Again” policy [website](#) dated 11/21 either. Rather, it discusses unleashing the “billions of dollars in projects held up by President Obama.” For example, Wilbur Ross and Peter Navarro, who were economic advisers to Trump during the presidential campaign, wrote in a 10/27 [report](#) that the blocked Keystone XL Pipeline project “would have amounted to an \$8 billion investment in U.S. infrastructure.” (By the way, Ross is a close friend of Trump and his pick for US Commerce Secretary. That role may be expanded under Trump, as discussed in a 12/9 *FT* [article](#).)

There are some specific dollars listed under the “Transportation & Infrastructure” section of the President-elect’s [website](#). It states: “Americans deserve a reliable and efficient transportation network and the Trump Administration seeks to invest \$550 billion to ensure we can export our goods and move our people faster and safer.” It isn’t clear to us if that’s incremental to the \$1 trillion noted above. We doubt it. It may not even be completely incremental to what the federal government is spending now. Congress approved a six-year \$305 billion highway bill last December, as pointed out a 11/15 [article](#) in *The Atlantic*.

(2) *Government-supported*. In their report, Ross and Navarro outline “The Trump Private Sector Financing Plan” to encourage “innovative” financing for infrastructure construction. It leverages a government-supported “equity cushion” to absorb the risk required by lenders. By the authors’ math, detailed in the report, “financing a trillion dollars of infrastructure would necessitate an equity investment of \$167 billion.” To “reduce the cost of the financing, government would provide a tax credit equal to 82% of the equity amount.” That translates to \$137 billion, which is big, but not as big as \$1 trillion!

Furthermore, Ross and Navarro argue that those tax credits would pay for themselves from the tax revenues generated from the projects. In addition, the tax credit could convert a tax liability into an infrastructure investment for companies with overseas earnings, say the authors--that is, if companies leverage the credit in tandem with the separately proposed 10% repatriation tax, which we discussed last week. Companies could bring back the funds, use them to invest in infrastructure, and eliminate the repatriation tax burden, they say.

From the report: “The mechanics of this are straightforward: Repatriate \$1 billion, incurring \$100 million of tax, and invest \$121 billion in the equity of an infrastructure project. The 82 percent tax credit on the \$121 thereby fully extinguishes the repatriation tax so at the end of the day they have a \$121 million infrastructure equity investment and no tax bill while the US has more and new infrastructure.”

Another competing proposal comes from Congressman John Delaney (D--MD). He discussed his May 2013 “[Partnership to Build America Act](#)” in a [segment](#) on CNBC on Monday titled “Democrats in Trumpland.” Delaney proposed a means to fund \$750 billion dollars in infrastructure investment. Like the scenario discussed above, it doesn’t require any appropriated funds. Support for it is questionable, and the logistics are complicated. Separately, a 12/12 MarketWatch [article](#) claims that under Trump, private investors could get the authority to raise household prices for tolls and service fees on

infrastructure usage in return for equity investments in it.

(3) *Unworking men targeted.* In any event, whether the stimulus is too little or too much, is it too late? Will it even work at or close to full employment? Job openings are at record highs. Unemployment is at record post-recession lows. Now, there are a lot of workers on the sidelines of the labor force who aren't counted in unemployment data. Many of them are retired. But an unusual cohort of prime-working-age men "neither employed nor in education or training" (NEETs) has been on the rise. That's per a 9/1 *WSJ* [opinion](#) piece titled "The Idle Army: America's Unworking Men." Navarro and Ross observe: "At present one-sixth of the 18 to 34 year old prime working age population is either unemployed or in prison and the minority group statistics are even worse. Infrastructure could help solve this sociological tragedy." Maybe so.

Many of those out-of-work men are low-skilled, undereducated, and discouraged, and some have even become mentally disabled. Some have lost jobs to overseas manufacturing or technology. Many workmen might have given up on reentry into the workforce if manual labor doesn't pay what it used to. Labor shortages already have been visible throughout the construction industry. That was evident in a 10/21 [update](#) on jobs from the Associated General Contractors of America (AGC). But in a 12/2 AGC [report](#), the association's chief economist claimed: "The industry would be adding more high-paid jobs if local, state and federal officials were investing more to build new and repair aging infrastructure."

(4) *Fed views.* Over the summer, Fed Vice-Chair Stanley Fischer and FRB-SF President John Williams began vocalizing a strong need for fiscal policy to jump in to revive US economic growth. More recently, FRB-Chicago President Charles Evans suggested that substantial spending on infrastructure would be ill-timed, according to a 12/5 *Chicago Tribune* [article](#). The US labor market is "kind of tight," he said. The article noted: "In such an environment, he said he wouldn't favor a program to build roads, bridges and other infrastructure merely [to] stimulate the economy. But he said the country needs a program for building highways, bridges 'and things we need.'"

FRB-SL President James Bullard discussed the "new policies being developed in Washington" in a 12/5 [speech](#). For now, Bullard continues to recommend a low and slow approach to interest-rate increases even in the new political environment. That could change, he said, if productivity is significantly impacted in the medium term by deregulation, infrastructure spending, or tax reform.

During November, Yellen warned fiscal policymakers against adding too much to the national debt, a 11/17 NPR [article](#) discussed. According to the article, her concern is that there wouldn't be much fiscal space remaining if the US economy were to encounter a shock down the road. Nevertheless, the article noted that she didn't see a reason to change her guidance on the Fed's gradual path of rate increases after the election.

At her press conference today, we expect that Yellen will say that monetary policy is still set for a gradual normalization of monetary policy. However, she will also probably say that the outlook for fiscal policy is evolving, and that could influence the course of monetary policy in the coming year.

CALENDARS

US. Wed: Retail Sales Total & Ex Auto 0.4%/0.3%, Business Inventories 0.0%, Industrial Production Headline & Manufacturing -0.2%/-0.1%, Capacity Utilization Rate 75.0%, Headline & Core PPI-FD 0.2%/0.2%, MBA Mortgage Applications, FOMC Announcement. **Thurs:** Headline & Core CPI 0.2%/0.2%, Jobless Claims 255k, Philadelphia & New York Fed Manufacturing Indexes 10.0/3.0, Housing Market Index 63, Current Account Balance, Weekly Consumer Comfort Index, Treasury International Capital. (Bloomberg estimates)

Global. Wed: Eurozone Industrial Production 0.1%/m/m/0.8%/y/y, UK ILO Unemployment Rate 4.8%, UK Jobless Claims Change & Claimant Count Rate 6.5k/2.3%, Australia Employment Change & Unemployment Rate 17.5k/5.6%. **Thurs:** European Car Sales, Eurozone, Germany, and France Flash Composite PMIs 53.9/54.9/52.6, Eurozone, Germany, and France Flash M-PMIs 53.7/54.5/51.9, Eurozone, Germany, and France Flash NM-PMIs 53.8/54.9/51.8, UK Retail Sales 0.0%/m/m/6.0%/y/y, BOE Rate Decision & Asset Purchase Target 0.25%/435b. (DailyFX estimates)

STRATEGY INDICATORS

YRI Weekly Leading Index ([link](#)): Our Weekly Leading Index (WLI)--a good coincident indicator that can confirm or raise doubts about stock market swings--rebounded 4.9% during the four weeks ending December 3 to another new record high, after slipping three of the prior four weeks by 0.9%. Our WLI is the average of our Boom-Bust Barometer (BBB) and Bloomberg's Weekly Consumer Comfort Index (WCCI). Our BBB jumped 9.0% over the four-week period, also to a new record high, following a four-week loss of 3.2%. Jobless claims edged up for the second week to 252,500 after falling the prior two weeks from 260,000 to 251,000--near the recent low of 249,500 eight weeks ago, which was the lowest since the week of November 3, 1973. The CRB raw industrials spot price index--another BBB component--jumped to its highest reading since December 2014. Meanwhile, the WCCI rose for the sixth time in seven weeks by a total of 9.2%.

S&P/Russell LargeCaps & SMidCaps ([link](#)): All these prices indexes have attained record highs since the election, but the SmallCap and MidCap market-cap indexes are easily leading their LargeCap counterparts ytd. Here's the ytd score and their percentage changes since Election Day: S&P SmallCap 600 (26.3% ytd, 16.9%), Russell SmallCap (20.9, 14.9), S&P MidCap 400 (20.3, 11.2), Russell MidCap (13.4, 7.3), Russell LargeCap 1000 (10.6, 5.7), and S&P LargeCap 500 (10.4, 5.5). The yearly changes in forward earnings for all three S&P indexes have been edging higher from six-year lows in early 2016 as y/y comparisons have eased. In the latest week, LargeCap's forward earnings improved to a 22-month high of 3.3% y/y from 3.2%, which compares to a six-year low of -1.8% in October 2015; MidCap's improved to 4.3% from 4.2%, but remains near early November's 18-month high of 4.5%, which compares to a six-year low of -1.3% in December 2015; and SmallCap's rose to a 23-month high of 7.9% from 7.4%, which compares to a six-year low of 0.3% in December 2015. Growth rates now expected for 2016 and 2017: LargeCap 0.6% and 12.2%, MidCap 1.5% and 12.5%, and SmallCap 6.8% and 15.7%.

S&P 500 Growth vs. Value ([link](#)): During 2015, the S&P 500 Growth index outperformed its Value counterpart (rising 3.8% vs Value's 5.6% decline), but so far this year Growth has underperformed--up 5.8% ytd compared with Value's 15.3% ytd advance. Growth is expected to deliver mostly higher forward revenue (STRG) and forward earnings growth (STEG) than Value over the next 12 months (6.3% STRG and 10.6% STEG, respectively, versus 5.2% and 12.2% for Value). Looking at forward revenues, Growth's forward revenues is at a cyclical high and 2.4% below its record high in September 2008. Value's is up 4.4% from its five-year low in February to a 12-month high, but is down 7.5% from its record high in October 2014. In terms of forward earnings, Growth's is up 8.4% from its 12-month low in January to a record high. Value's forward earnings has risen 6.1% from its three-year low in March to a 23-month high, but remains 3.5% below its record high in October 2014. Growth's P/E of 18.0 is up from the October 2015 low of 16.8, and approaching its 10-year high of 19.1 in February 2015, while Value's, at 15.7, is up from January's two-year low of 13.2 and slightly below late November's 12-year high of 15.9. Regarding NERI, Growth's has been positive in five of the past seven months, but fell to a seven-month low of -4.9% in November from 2.0% in October; that compares to a five-year high of 5.8% in June and a five-year low of -16.2% in April 2015. Value's NERI was negative for a 28th straight month in November, and weakened to -2.8% from -1.0% in October; that compares

to a 10-month low of -18.0% in February and a five-year low of -20.3% in April 2015. Growth's projected forward profit margin of 13.4% is up from a three-year low of 13.1% in April and down from a record high of 14.2% in December 2015, while Value's 9.2% remains a hair below its eight-year high of 9.2% in January.

US ECONOMIC INDICATORS

NFIB Small Business Optimism Survey ([link](#)): "Before Election Day small business owners' optimism was flat, after Election Day it soared," according to NFIB's president and CEO. November's Small Business Optimism Index (SBOI) jumped 3.5 points to 98.4 (highest since December 2014)--above its 42-year average for only the third time since 2007. (The SBOI was basically unchanged from October's reading up to the point of the election, and then rose dramatically after the results of the election were known.) Eight of the 10 components advanced last month, led by expected better business conditions--which surged 19ppts from -7% to 12%--and sales expectations (to 11% from 1%). Also boosting the SBOI were the two employment-related components: plans to increase employment (15 from 10) and current job openings (31 from 28). Only capital spending plans (24 from 27) fell; current inventory was unchanged at -4%. According to the report, "Federal taxes, regulations, and Obamacare are the three biggest impediments to running a small business in America. Small business owners have high expectations that those problems will be addressed."

Import Prices ([link](#)): Import prices in November fell 0.3% after gains of 0.4% and 0.1% the previous two months. Petroleum prices sank 4.7% after a two-month surge of 7.9%. Nonpetroleum prices (which include natural gas) were flat after slipping 0.1% in October, which was the first negative reading in four months. The yearly rate for total imports was negative for the 28th month, at -0.1%, though is about to turn positive. Nonpetroleum prices were 0.2% below a year ago, narrowing steadily from -3.7% y/y at the end of last year. Import prices from Japan increased 1.3% y/y, turning positive in August for the first time in 43 months; import prices from NICs (-1.2% y/y) and China (-1.5) are still falling, though at a slower pace.

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