US Elections and Impact on Indian Capital Markets

November 08, 2024 l Economics

Republican Party's Donald Trump became the 47th President of the United States (US) for a second term after a gap of four years. The Presidential election was held on November 5, 2024, and was closely contested against Democratic Party's Kamala Harris. Trump will take charge as President from Joe Biden of the Democratic Party.

The US uses an electoral college system, whereby citizens elect the President and the Vice President indirectly through their state's electors. Of the total 538 electoral votes, 270 votes are needed to win the Presidency. There are primarily seven states, commonly known as the "swing states", that are instrumental in determining the winner of the US Presidential elections. These states are Michigan, Nevada, Pennsylvania, Wisconsin, North Carolina, Georgia and Arizona.

Trump won a total of 295 electoral votes at the time of preparation of this report and was leading in other states that are yet to be called. Trump is also on track to win the national popular votes (71.9 million), which he had missed achieving during his last term in 2016 and could, in fact, be the only Republican candidate to achieve that feat in the last 20 years. Of the 50 states, 31 voted for Trump. Trump managed to gain victory in five out of the seven swing states, and at the time of writing this report, he was leading in the other two states namely, Arizona and Nevada, where the results are yet to be declared.

The Republicans have secured a Senate majority and are leading in the elections for the House of Representatives. If Republicans gain control of both the chambers, Trump will be able to pursue his policy agenda more smoothly.

Key Points from Trump's Election Manifesto

Taxes: Trump plans to extend the tax cuts that were introduced in 2017 under the TCJA (Tax Cuts and Jobs Act) and are set to expire in 2025. TCJA includes individual income and estate tax cuts.

Trump promised to reduce the corporate tax rate to 15% from 21% for companies manufacturing in the US. Additionally, Trump has also promised to cap interest rates on credit cards at 10% to reduce the burden of credit card debt, make interest payment on car loans fully tax deductible, stop tax on social security benefits, provide tax credits for family caregivers (to help aging seniors and family members), large tax credit for childcare, and remove the USD 10,000 limit on deductions in state and local tax.

Though these fiscal measures could improve the consumption spending in the US economy, they could be inflationary and will also lead to a wider fiscal deficit. The US already had a high fiscal deficit of 6.3% of GDP in fiscal year 2024 and a high government debt at 123% of GDP.

Trade Tariffs: Trump has proposed to impose 60% tariffs on imports from China and 10-20% tariffs on imports from the rest of the world.

Trump has also proposed 100-200% tariffs on cars manufactured in Mexico to encourage and increase job creation in the US automobile industry. Additionally, he mentioned 25% tax on all other imports from Mexico unless the latter clamps down on border crossing. Through these moves, Trump aims to prevent Chinese companies from setting up plants in Mexico to avoid US tariffs.

Higher tariffs could result in disruption of global trade flows and overall weaker trade growth. They will also lead to inflationary pressure in the US economy, with upward pressure on prices of imported goods. India could benefit from any re-orientation of the global supply chain away from China. However, a slowdown in overall global trade would have negative repercussions for India too.

Foreign Policy: Trump indicated he would end the war between Russia and Ukraine and the conflict in the Middle East. However, he has not outlined how he plans to stop these conflicts. In the past, Trump has indicated his support towards Israel.

Based on the manifesto, Trump has said he will ensure the NATO members meet the requirement of spending at least 2% of the GDP towards defence, as many are not currently meeting this threshold.

Immigration Restrictions: Trump aims to ensure strict rules on immigration policies. The new government particularly promises to increase penalties for illegal entries and those staying beyond what is permitted in their visas.

Stricter policies on outsourcing and restrictions on H1 B visas could weigh on India's IT sector, which relies heavily on the US market. Indians receive the highest number of work visas from the US, mainly for the IT sector.

Energy: Trump, in his election manifesto, indicated the intent to reduce energy prices by increasing domestic fossil fuel production. The new administration plans to end delays in permits and leases for drilling and remove all the hurdles surrounding oil and gas projects. Trump also plans to remove subsidies for green technologies under the Inflation Reduction Act (implemented in 2022) and do away with the restrictions on greenhouse gas emissions. Additionally, Trump also pledged to remove limits on natural gas exports.

Increased US oil production and easing of global crude oil prices would be a positive for the Indian economy, as India's oil import dependency is high at around 85%.

Market Reaction

Trump's proposed policies are expected to be inflationary. He has outlined plans to extend personal tax cuts, reduce corporate tax rates, and impose a 60% tariff on imports from China, along with a 10-20% tariff on imports from other countries. These tax cuts are likely to widen the fiscal deficit of the US, while the tariffs would raise the prices of imported goods. However, the overall impact will depend on the degree of tariff implementation and any potential trade negotiations, which remain uncertain at this stage.

Indian Yields: The 10-year US Treasury (UST) yield began rising in the lead-up to the US elections, as markets started to price in the likelihood of a Trump presidency. On the day of the election results, the yield surged by 15bps. Cumulatively, the 10Y UST yield has increased by 59bps over the last month (up to November 07). Domestic yields have followed this upward trend, although to a lesser extent. The 10-year Indian GSec yield rose by 6 bps over the last month, reaching 6.8% (Refer Exhibit 1 and 2).

FPIs turned net sellers of Indian debt in October for the first time since April, driven by the narrowing interest rate differential between India and the US. This sell-off in Indian debt markets contributed to the upward pressure on domestic yields. However, in November (up to the 7th), FPIs have shifted back to being net buyers of Indian debt. In its November 6-7 meeting, the Fed cut its policy rate by 25bps, following a 50bps reduction in September. While markets expect further Fed cuts as US inflation has eased considerably to 2.1% (PCE inflation) from its pandemic peak of nearly 7%, there is an expectation that the Fed will slow the pace of rate cuts under Trump's administration. As a result, UST yields are likely to trade higher than initially anticipated, putting upward pressure on domestic yields in the near term. However, we believe there are chances of RBI to begin a rate cut cycle in FY25, provided food inflation moderates. This would likely alleviate pressure on domestic yields over the medium term. Additionally, some of Trump's proposed policies may reduce global demand, potentially lowering commodity prices (including crude oil) and easing pressure on inflation and yields in India.

Indian Rupee: The US dollar index (DXY) rose by 3.3% over the past month (up to November 07), driven by higher UST yields. A stronger dollar has weighed on emerging market currencies, including the rupee, which hit a record low of 84.4 against the dollar (Refer Exhibit 3 and 4).

FPI outflows have further contributed to the rupee's depreciation, with FPIs pulling out approximately USD 1 billion on a net basis from Indian markets in November (up to the 7^{th}). This follows the highest FPI net outflows of USD 11 billion in October since 2020, primarily from Indian equities. While higher UST yields and a stronger dollar have played a role in these outflows, other factors have also been at play, such as reallocation to Chinese stocks, emerging domestic growth concerns, muted corporate earnings, and high domestic valuations.

Looking ahead, a stronger dollar under a Trump administration is likely to maintain a weakening pressure on the rupee in the near term. However, India's healthy forex reserves should help the RBI manage rupee volatility effectively.

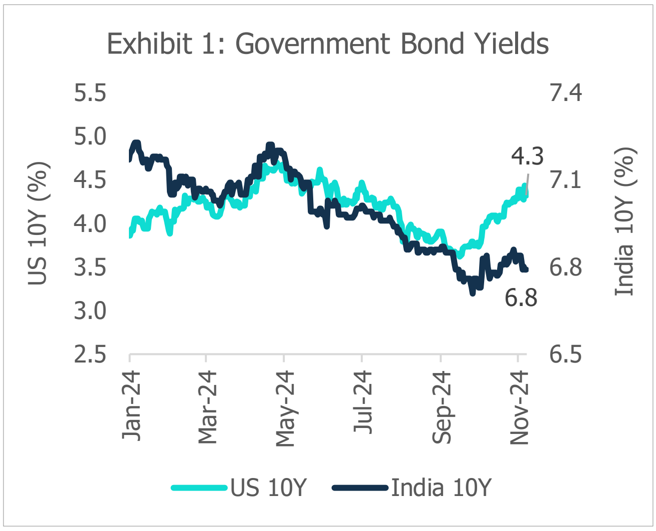
In the medium term, FPI inflows into India are expected to return once there is greater clarity on Trump's policies, which should help ease pressure on the rupee. Additionally, passive inflows from India's inclusion in global bond indices could provide some support. Currency pressures could also ease if crude oil prices remain in check or decline under Trump's presidency.

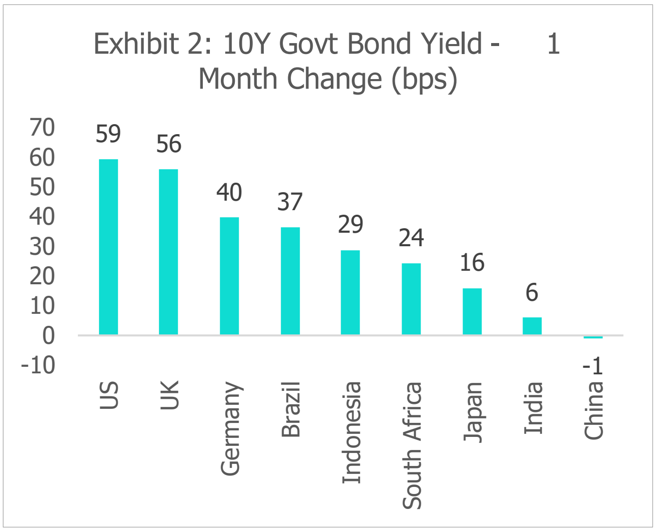
Notably, the rupee is expected to face less pressure compared to the yuan, which could bear the brunt of Trump's proposed 60% tariff, or other Asian currencies with significant exposure to China.

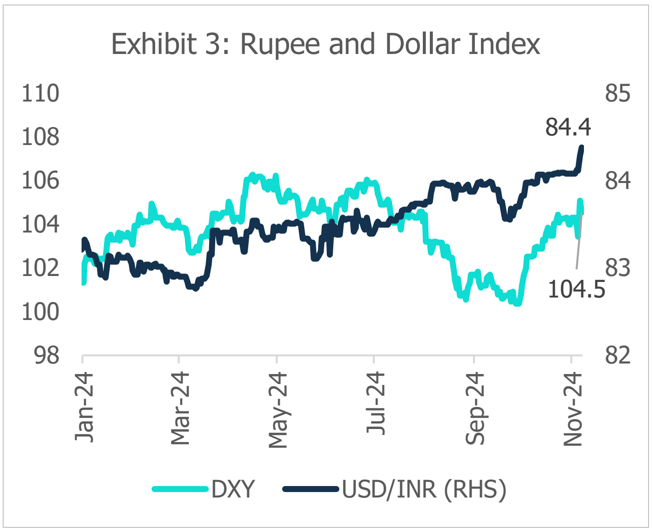
Going ahead, it is important to monitor some key factors that are likely to shape market dynamics such as the degree of tariff implementation, as it remains unclear whether Trump will impose tariffs as proposed or to what extent countries beyond China might be affected. Another crucial factor is China's response to these tariffs. If China can implement stimulus measures or fiscal policies to mitigate the impact on its economy, it could help reduce pressure on the yuan and other Asian currencies.

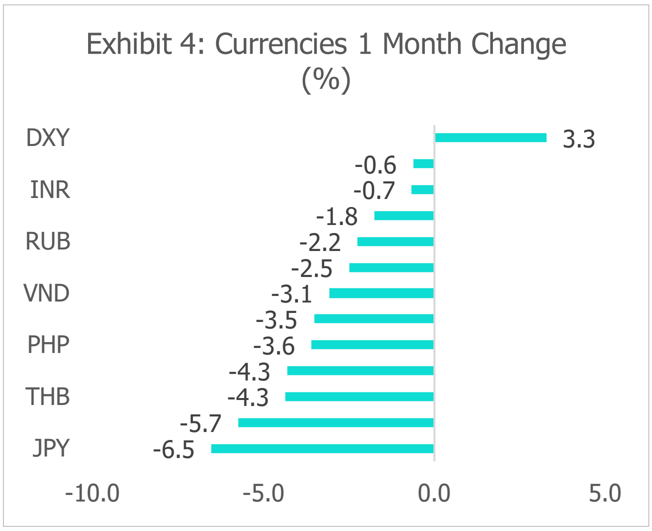
Table 1: Trump will inherit an economy with higher inflation, a larger fiscal deficit, and increased public debt compared to his first term. Here's a snapshot of key US economic indicators when Trump won the 2016 election versus now:

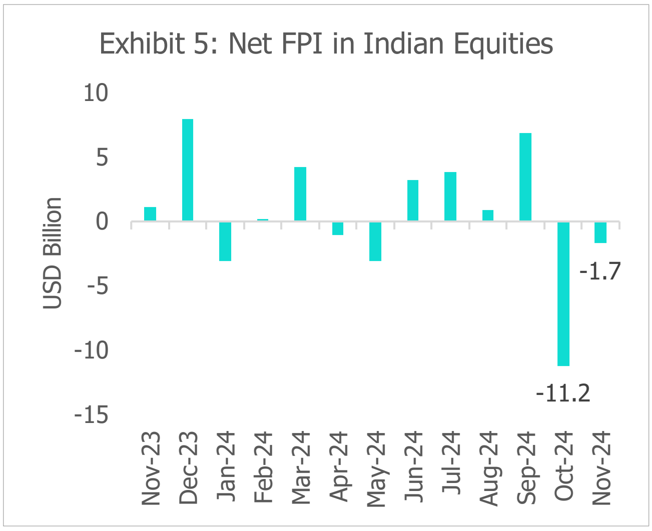
	2016	2024
10Y UST Yield (%)	1.9	4.3
Dollar Index	97.9	104.5
US Inflation (%)	1.4	2.1
US Fiscal Deficit (% of GDP)	3.0	6.3
US Public Debt (% of GDP)	105	123

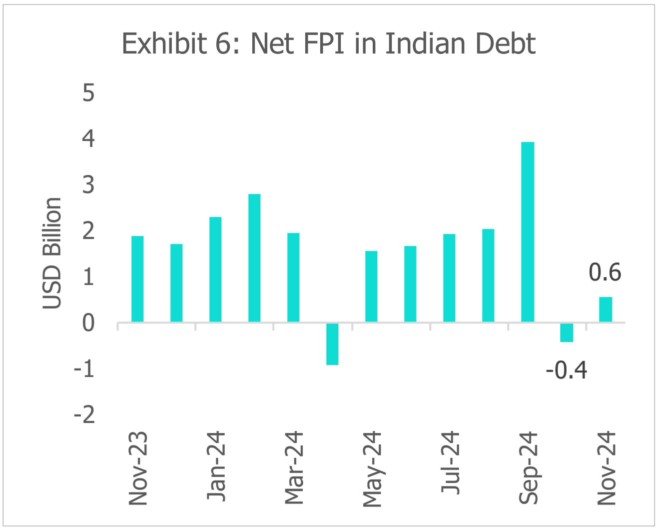












Sources: Fiscal Data (The Department of Treasury and Bureau of Fiscal Service), Refinitiv, NSDL. Data as on November 07.
Note: For Currencies 1 Month Change (%), negative values imply currency has weakened against USD (except for DXY, which measures dollar's strength against a basket of currencies).

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