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Trump Runs the Economy Hot

CAPITAL ACCOUNT

By Greg Ip

Most years, presidents don't have much impact on the economy.

This year won't be like most years. President Trump is taking unprecedented steps to run the economy hot, and there is an excellent chance he'll succeed.

Washington has three big levers that affect growth: fiscal policy (taxes and spending), monetary policy (interest rates) and credit policy (the ease of borrowing). Historically, they were not coordinated: Fiscal policy followed the congressional cycle, monetary policy was set by an independent Federal Reserve and credit policy reflected often random decisions by regulators.

Note

This year, all three are dialed toward stimulus, reflecting a single-minded focus by Trump and congressional Republicans on faster economic growth.

In the process, they are compromising other goals: taming debt, Fed independence and long-term financial stability. The consequences of that come later.

The fiscal flip

Note

GDP

The first reason to be bullish on 2026 is that 2025 was remarkably good (even if many Americans disagree). Gross domestic product adjusted for inflation probably grew around 2.5%, in line with the solid pace of the previous two years. The main drivers were investment in AI and data centers, plus consumer spending boosted by the stock market.

Note!

So the baseline for growth in 2026 should be well above 2%. Now recall that last year's performance came despite restrictive fiscal policy. Trump's tariffs raised roughly $200 billion, most of it paid by American businesses and households.

This year, average tariffs aren't going up, and might go down if the Supreme Court rules that some were imposed illegally.

Note

Meanwhile, the tax-andspending bill Trump signed into law delivers new or expanded tax deductions. Many workers will see both higher take-home this month and a refund on last year's taxes when they file their returns.

Note

Donald Schneider, a policy analyst at Piper Sandler, sees this injecting nearly $200 billion into the economy, enough to boost first-half annualized growth up to half a percentage point.

The credit boost

Investment is driven heavily by the appetite for risk. Still, government can damp or stoke that appetite.

Lax oversight allowed subprime mortgages to feed the housing bubble in the early 2000s. In the wake of the crisis, new rules required banks to hold more capital against loan losses and cash to handle funding outflows, which constrained their lending. Note

Note

Under Trump, regulators have moved to undo those restrictions. One set of eased rules enabled big banks to hold more Treasurys. Capital requirements are on course to be loosened. Barriers to bank mergers are coming down, and enforcement of consumer-finance laws has been rolled back. All of that should fire up lending.

Two decades ago, Fannie Mae and Freddie Mac loaded up on risky mortgage-backed securities, which incurred massive losses when the housing bubble burst. They nearly failed, forcing the Treasury to take effective ownership of the quasi-private companies in 2008. Trump just ordered Fannie and Freddie to buy $200 billion in mortgage bonds, which could lower mortgage rates by 0.1 to 0.25 percentage point, according to UBS, boosting home-buying.

The full punch bowl

The Fed's job, former Chair William McChesney Martin famously said, is to take the punch bowl away just as the party gets going. When growth was hot and financial speculation rampant, the Fed would raise rates to head off inflation.

Trump hates that. He thinks the Fed chair should reinforce his other economic policies, not lean against them. "I want somebody, that when the market is doing great, interest rates can go down because our country becomes stronger," he said in Detroit on Tuesday.

For that reason, he has gone to extraordinary lengths to try to take control of the Fed, seeking to fire one governor over alleged mortgage misrepresentations, and now allowing his Justice Department to criminally investigate Chair Jerome Powell.

Powell looks determined to stay through the end of his term as chairman, in May. Fed officials now see rates falling from their current range of 3.5% to 3.75% by a quarter of a point this year, which would leave rates roughly at "neutral," neither restricting nor stimulating growth.

Trump doesn't want neutral, he wants stimulative, and is adamant that the next chairman cut rates by a lot. His two leading candidates, adviser Kevin Hassett and former Fed governor Kevin Warsh, have agreed. Perhaps they won't cut to 1%, as Trump wants. But expect a dovish bias from both.

Note

They are likely to have favorable inflation news this year as justification. Tariff effects are fading, oil prices are headed down, and a glut of rentals is nudging down housing inflation. With job creation weak, wages aren't growing that fast either.

The consequences

Note

The near-term impact of opening the fiscal, monetary and credit throttles is easy to predict: rapid growth. But if juicing the economy is so rewarding, why don't more presidents and Congresses do it?

Note

Because of the long-term consequences. Trump didn't put the debt on its course to top 100% of GDP, but he isn't slowing it either. Ever-rising debt leaves future generations poorer and risks a debt crisis. Loosening credit and dialing back regulations, when valuations are already stretched, could end in a market bust. But with the Fed easing, don't expect bond-market vigilantes to punish budget deficits or markets to crash. Note

And as for the central bank subordinating itself to the president's other goals: that, too, usually ends badly. Just don't bet on the end coming this year.