

Trump's economic incoherence

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The FT reveals the world's confusion about Trump's economic plans this morning. In just one email alert there are the following headlines:

You might think that the FT is rattled, and you would be right. They think Trump is going to rock the US, and so the world, economic order. He will if he does the things he has said he will. And Congress may, unusually, back him in doing so. And that is what is worrying.

The concern is based on the incoherence of the plan, it's timing, and the potential longer term consequences and spreads over a number of issues.

First, it's obvious that Trump intends to spend. I have no problem with that. I have been to the States twice this year; it is obvious that it is crumbling. Any president needed to rebuild it: its economic future would be grim if they did not. So fiscal policy is in: I have no complaint. But let's be clear, this will happen when the US is already seeing growth and when there is relatively high employment: Obama has already got the economy on some sort of track, albeit without tackling infrastructure. So any such spending has to be matched with anti-inflationary policies, like prudent taxation measures to reclaim the money that the state will be injecting into the economy to keep the purchasing power of the currency on an even keel.

But tax cuts across the board, although most especially for the wealthy, are also on the agenda. For most of America the gains will be small: for the wealthiest his cuts will

increase their net income by up to 14%. There are three consequences: a minor spending boom and a massive savings glut at the top. The first will suck in imports if infrastructure spending claims much of the spare labour in the economy. The saving boom increases inequality and will fuel financial services.

Those savings will also be amply rewarded: interest rates are going to rise, without a doubt. Trump thinks the Fed has run an unnatural economic policy by keeping them low, so up they will go. I am not going to predict by precisely how far they will rise, but I am expecting a two or three percentage point increase over time. The excuse will be that this constrains inflation whilst sucking hot money into the US to pay for the combination of spending and tax cuts, which inevitably mean borrowing in the short term. There will also be a need for an interest rate rise to tackle the loss in confidence in the dollar when tariffs and other trade measures are imposed.

The knock on effect will be a massive boost to the financial services industry - which is going to see many of the regulations imposed post 2008 removed. We are heading back to the wild west days of unregulated finance: debt booms are on their way.

As will inflation be back. This is nigh on inevitable with this combination of policies. That of course can justify the interest rate rises, but I suspect Trump wants to increase real returns as well as nominal ones, so the issues are not wholly related.

And let's not pretend that Trump's largesse is universal: twenty per cent of Americans will lose their healthcare. Poverty will increase as a result. The environment will be trashed with untold long term cost. Eleven million people are to be expelled from the US, creating a labour crisis. It is likely that many benefits will be reduced to pay for some of this programme. Republican USA will not change all its spots. This is domestically bad news for many in the US

And the ramifications will spread: US interest rates will travel fast. The UK will respond. So too will trade aggression: there will be reactions. This is not then an issue of US concern alone. Making sense (or otherwise) of all this is important.

So, let's address the issues. I have made it clear since 2008 that I want a fiscal stimulus for the UK. I have not changed my mind. I also know that the US is critically short of government investment. So I have to welcome any programme to address that issue. But, and that is a massive but, there have always been caveats to my enthusiasm because although I am also more relaxed about inflation than many (I would have a 3% target, for example) an economy out of control has no benefit for anyone, at all.

And fiscal stimulus, by a combination of large scale spending and simultaneous massive tax cuts for a few whilst imposing cost increases on many by interest rate rises and tariff impositions when the economy is already relatively near full employment, looks to me like the perfect recipe for an inflationary boom and massive bust.

In the short term (up to two years; enough to win the mid term elections) there will be economic growth with some disruptions only for the poorest that will be ignored by the media and most in the population. Inflation will not take off immediately. But the problems will be growing quite rapidly even by then.

Cost of living increases will result in a debt spike.

Many will not be able to afford their mortgage repayments as interest rates rise and wages don't, at least at first.

Inflation will grow, and exponentially as the impact of the policy itself grows.

The obvious inequality of the benefits will fuel social tension.

A short term stock market boom will eventually be tempered by trade and debt concerns that impact profit.

The US will discover that as migrant labour is sent home there won't be the people needed to build the infrastructure after all. Or to do quite a lot of other things either.

And that wall with Mexico will become a symbolic failure of the programme as nothing happens.

To put it bluntly; the whole economy will become unbalanced. Near full employment will become full employment as attempts to repatriate many workers who are key to the US economy (although few have realised it) begin. Economic stimulus in that situation can only mean inflation. And tax is the only true anti-inflationary tool (as I argue in the Joy of Tax) meaning that right now the fiscal stimulus should be matched with tax increases because of the risks to the economy. The exact opposite will happen and the whole thing faces the risk of serious economic collapse. That may not happen in four years. It would in eight.

The moral? Don't put a man with a micro brain in charge of the macroeconomy. he will never understand it. But we're all going to pay the price for his failure of comprehension, including in the UK. Start budgeting for an increase in your mortgage at the same time as the economy slows down again: that's the message from Trump.