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Abstract

The turbulent first eleven months of Donald Trump's second presidency has been characterized by policy actions and statements that create large uncertainties and sideline multilateral cooperation. The Trump administration has fueled substantial trade policy uncertainty globally, as well as pushed protectionist policies that have induced negative supply shocks to the US economy. Monetary policy is frustrated by inflationary pressures from an elevated federal deficit. Green energy projects are proactively sidelined in favor of a return to fossil fuels. Stricter immigration policy and deportation of undocumented migrants threatens to reduce US economic output, adding to price pressures. The eventual push-back from the general public, courts and lawmakers has yet to materialize, so the Trump administration continues to move ahead on deregulation of financial markets, including the easing of capital and stress testing, as well as a modifying the laws and regulations affecting bank mergers and crypto currencies.

Keywords: tariffs, trade war, fiscal policy, federal deficit, green energy, fossil fuels, deportations, financial deregulation, small open economies

[1] We are grateful to our colleagues for their valuable comments and contributions.

1. Introduction

The second Trump administration hit the ground running on implementation of a wide-ranging domestic and foreign policy agenda that emphasizes economic nationalism, protectionism, and deregulation of financial markets. Despite better preparation for the second term the administration's first eleven months hardly seems scripted. The administration continues to employ unorthodox negotiation methods and unpredictability at the price of long-standing alliances, even at the risk of economic self-harm.

President Trump's Liberation Day declaration on April 2, 2025, heralded an increased use of tariffs in negotiating leverage with foreign trading partners. Domestically, the administration's fiscal policy increased the federal debt ratio. Such spending plans are likely to keep inflationary pressures elevated, a condition at odds with Trump's campaign promise. Moreover, stricter immigration policies and mass deportations of undocumented migrants (who constitute roughly 5 % of the workforce) entail a severe negative supply shock, suppress economic activity, and fuel wage and price pressures. Deregulation is a major paradigm in the administration's policies, including in the financial markets. Banks are likely to face significantly lower capital requirements, while crypto assets (as evidenced in July with the passage of the Genius Act) could receive quite favorable treatment.

Trump's executive order to review US participation in certain international organizations, including several UN suborganizations,[2] with a view to possible withdrawal and termination of US funding, complements his earlier decisions to withdraw from the World Health Organization (WHO)[3] and the Paris Climate Accord.[4] Despite an August deadline, the administration has yet to take further action on withdrawing from organizations under review. In addition, Trump has threatened to pull the US forces out of Europe, with the result that the EU and European NATO

[2] See Withdrawing the United States From and Ending Funding to Certain United Nations Organizations and Reviewing United States Support to All International Organizations, The White House, February 4, 2025.
[3] See Withdrawing the United States from the World Health Organization, The White House, January 20, 2025.
[4] See America First Trade Policy, The White House, January 20, 2025.

members have significantly increased their defense spending. In June, European NATO members agreed to increase their defense budgets ultimately to 5 % of GDP.

Trump, who is limited by the US Constitution to two terms, faces mid-term elections in November 2026, as well as fractures within the Republican Party. Some of the administration's more outlandish initiatives are likely to be curtailed by the opposition, legal action, and public sentiment as economic headwinds become more challenging.

2. Trade and tariff policies – a continuum of uncertainty

During his first term, President Trump shifted US trade policy by imposing tariffs on imports from China, the EU, Canada, and Mexico. Many of these tariffs remain in effect. The tariffs were targeted at specific products such as washing machines, solar panels and certain metals such as aluminum and steel. Throughout his campaign for the second term, Trump repeatedly promised to set and extend a range of tariffs on both allies and adversaries with proposed rates varying dramatically from 10% to 100%, depending on the audience and context. In his rhetoric, tariffs were promoted as the means to make America great and prosperous.

President Trump accelerated the pace and scale of tariff policies in his second term, signaling his administration was better prepared for power consolidation than in 2017. On the first day of his return to office, Trump signed the "America First Trade Policy" executive order, reiterating his commitment to revitalizing US industry through protectionist measures.[5] The threat of tariffs materialized in early February with the announcement of tariffs on Chinese, Canadian and Mexican goods. It was followed on April 2 with the unveiling of reciprocal tariff rates. The Liberation Day tariffs included a 10 % baseline on nearly all countries.

[5] See America First Trade Policy. The White House, January 20, 2025.

Liberation Day triggered market turbulence and caused some countries to rush to the negotiation table to seek concessions from the US. Trump postponed the imposition date for tariffs for 90 days to allow negotiations, signaling that the announced rates ultimately were to be used as bargaining chips.

Nevertheless, several significant agreements were reached during summer 2025, including the EU's negotiating of a 15 % base-level tariffs with the US in late July that included several major exceptions. The US has so far negotiated deals with the UK, Japan, Vietnam and others, but the talks are on hold with several major US trading partners, including Mexico, Canada, and China. The ongoing trade situation has generated a fog of uncertainty that has depressed global economic and trade activity, as well as capital investment. The global economy nevertheless remains resilient to the tariff jostling, although some of this may reflect the frontloading of procurements before scheduled tariff imposition. Global supply chains have also displayed resilience and adjusted quickly to the new environment.

The empirical evidence does not back the Trump administration's protectionist approach to incentivizing domestic manufacturing investment and reducing the US trade deficit. Recent research suggests that Trump tariffs have tended to discourage and postpone investment domestically and internationally, and have only managed to narrow bilateral trade deficits slightly at the expense of lower economic growth. Consistent with the evidence from his first term, the effects of tariffs are at best neutral. Most come with significant negative effects and costs to GDP growth, employment, and world trade, while increasing domestic price pressures. Previous studies point out that costs of tariffs in the previously mentioned forms were largely paid by US households and companies (Amiti et al., 2019; Barbiero et al., 2025; Boer et al., 2024; Caldara et al., 2019; Cavallo, 2021; McKibbin et al., 2024).

Despite the negative economic effect and disruptiveness of tariffs, their economic impact shouldn't be overstated as their effects are likely mitigated via exchange rate movements and trade flow adjustments.

The trade war impacts Europe's Small Open Economies directly and indirectly. The direct hit from tariffs on Europe's Small Open Economies is most likely modest,

whereas the indirect effects are significantly larger, deriving from slowing global growth and trade, and especially the vast economic policy uncertainty (Jouvanceau et al., 2025). Many Small Open Economies such as the Nordic and Baltic states are heavily dependent on trade, which amplifies the negative effects of the trade war on them.

Studies from Trump's first term suggest Small Open Economies remain vulnerable to tariff spillover effects. Even if the impacts of direct tariffs are significantly worse, Small Open Economies are disproportionally vulnerable to trade shocks – even tariffs on China and Mexico hurt European value-added (Goes and Bekkers, 2023; Ali-Yrkkö and Kuusi, 2017). Recent publications indicate that the trade war could cut global GDP growth and dampen Small Open Economy growth more than a direct tariff hit via uncertainty, supply-chain spillovers, and counter-tariffs (Juvonen et al., 2025; Anttonen et al., 2025).[6] While inflation projections vary depending on the study, there is a broad consensus among researchers that tariffs are likely to be passed through to consumer prices in the US and in its trading partners, and that the inflation pressures are likely higher in the US than elsewhere. Tariffs on raw materials and parts inflict larger GDP losses than tariffs on consumer goods, implying that Trump's exception tariffs on steel, aluminum, and semiconductors could affect Small Open Economies than lower end-product tariffs (Gnacato et al., 2025).

The ongoing threats and use of tariffs, along with retaliatory measures, have created a climate of uncertainty. Market volatility remains high. Even completed trade deals leave the contracting parties unsure as to what was agreed, which rate schedules to follow, and how long the parties should expect the arrangement to remain in place. The uncertainty surrounding US trade policy has prompted many nations to seek alternatives.

[6] See Swedish exports to the USA – Which sectors are most affected by higher tariffs?, Sveriges Riksbank.

Amendment of trade agreements offers a partial solution. For example, the trade agreement between the EU and Mercosur (signed in December 2024), Regional Comprehensive Economic Partnership (RCEP) agreement in Asia and the continued talks on expanding the African Free Trade Agreement (AfFTCA) highlight a collective desire for stability and the need for open, rules-based trade. While these trade agreements involve lower-than-threatened tariff levels, they still impose economic costs.

The US effective global tax rate is now approximately 17 %, putting it in the range of the Smoot-Hawley Tariff Act during the Great Depression of the 1930s. Trump's transactional approach to trade negotiations is likely to continue to risk intensifying fragmentation of international trade, investment, and production, increasing economic inefficiencies.

Additional uncertainty surrounds the legality of the Trump tariffs themselves. Although the executive is granted wide powers with regards to tariff policy, the Trump tariffs stretch the Article 1 taxation powers of granted to Congress under the US Constitution. The Trump administration, which has relied on the International Emergency Economic Powers Act of 1977 to justify its override of congressional taxing power, has recently found itself making its case to the US Supreme Court. Should the court decide the Trump tariffs are unconstitutional, it could also require the government to refund the $200 billion or so in tariffs collected.

3. Fiscal policies – more support, more inflation

The One Big Beautiful Bill is projected to increase federal deficit spending by more than $3 trillion over the next ten years. The One Big Beautiful Bill (OBBB) Act of 2025 extends the tax cuts of the Tax Cuts and Jobs Act of 2017 and adds many new exemptions and deductions. It also alters requirements for Medicare and food stamp eligibility, serving essentially as de facto cuts to these programs. The Congressional

Budget Office (CBO) estimates the tax bill will cause a net increase in the federal budget deficit of $3.4 trillion over the next decade.[7]

Despite the hype, the DOGE cuts did little to reduce federal spending. Following its establishment in January 2025, the Department of Government Efficiency (DOGE) started its ambitious mission to curb federal spending and increase its productivity. Initially, DOGE's nominal head Elon Musk (although his official governmental position never clear) suggested that cutting of up to $2 trillion – 30 % of the federal budget – was doable. Between February and May DOGE initiatives mainly focused on downsizing the federal workforce, shutting down certain federal operations and disposing federal property gain momentum. In total, over 260,000 federal employees were fired, retired early, or opted for buyouts. By May, DOGE's momentum had waned, with Musk ceasing to play an active role in DOGE. The initiatives were also starting to face legal and political pushback. DOGE claimed in June that it had made $180 billion in cuts,[8] roughly 9 % the initially claimed $2-trillion figure and 9.8 % of the FY2024 federal deficit. Indeed, the federal deficit for FY2025[9] ended up being only 2.7 % smaller than that of FY2024.[10]

In addition, the DOGE cuts have likely been quite costly. The Yale Budget Lab estimates suggest that the workforce cuts to the Internal Revenue Service (IRS) alone could increase federal tax noncompliance significantly, due, among other things, to fewer tax audits.[11] Assuming 7,000 layoffs of IRS personnel, the effects in FY2026 alone could result in $3.3 billion of forgone revenue. With a 50 % IRS staffing reductions, the loss climbs to $18.8 billion. Considering additional behavioral effects such as incentivized tax misreporting, the Yale Budget Lab estimates the federal tax gap could widen by $100–200 billion in FY2026. These estimates are only speculative, of course, as the situation remains fluid.

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[7] See Estimated Budgetary Effects of Public Law 119-21, to Provide for Reconciliation Pursuant to Title II of H. Con. Res. 14, Relative to CBO's January 2025 Baseline, Congressional Budget Office.
[8] See: https://doge.gov/savings
[9] The US federal fiscal year runs from October 1 to September 30.
[10] See National Deficit, US Treasury Department Fiscal Data.
[11] See The Revenue and Distributional Effects of IRS Funding, The Budget Lab at Yale.

Any major reduction in federal spending would require sizable downsizing of politically popular programs. Mandatory spending in FY2024 (includes social security, Medicare, and net interest payments) accounted for 73.2 % of the federal budget. In addition, defense spending accounted for another 12.6 %. As such, it should not come as a surprise that with the DOGE cuts mostly focusing on the remaining 14.2 % of discretionary spending, the cuts have remained modest in relative terms. Thus, achieving major spending cuts would require entitlement reform such as the increasing retirement age, cutting entitlements , and downsizing Medicare. There are no signs that the administration is considering such universally unpopular actions. Sizable defense cuts are also unlikely (Fatás and Panizza, 2025).[12]

It is hard to see prospects for a decrease in the federal deficit or stabilization of public debt, both of which are already huge. In FY2024, the federal deficit increased to 6.4 % of GDP. The IMF projects that the US public indebtedness will rise from around 122 % of GDP in 2024 to 143 % in 2030 (IMF, 2025). With Trump's agenda suggesting net spending increases, any sizable decrease in the federal deficit would have to come from a boost in tax revenue from higher economic activity or the imposition of new tariffs.

In any case, the prospects of unleashing major and persistent growth seem unlikely. According to the estimates of Ascari et. al. (2024), on-year real GDP growth would have to remain above the wildly implausible level of 4 % a year to cause any substantial reduction on the debt-to-GDP ratio. Consequently, the IMF projects the deficit-to-GDP ratio to further widen for the next few years (IMF 2025). Additionally, revenue from 10–25 % tariffs on Mexico, Canada, and China are estimated at about $100 billion, roughly 10% of the FY2024 deficit,[13]

It should also be noted that above estimates assume the current fiscal trajectory. Any major shocks that promptly required major fiscal spending such as a financial crisis or war would only exacerbate the situation.

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[12] Chapter 2 in: The economic consequences of the second Trump administration: A preliminary assessment, CEPR.
[13] See Trump Tariffs: The Economic Impact of the Trump Trade War and How Much Revenue Will Trump's Tariffs Raise? February 4, 2025.

Expansionary fiscal policy, tariffs, and a cooling economy could create difficult trade-offs for the Fed. In general, tariffs act as an adverse supply shock for the imposing country – and doubly true if that country is running large trade deficits. This creates difficult employment/inflation trade-offs for the Fed. On one hand, the tariffs and the uncertainty surrounding them raises the risk of recession, which typically warrants monetary easing. On the other hand, the tariffs are already being passed on to consumer prices.[14] In addition, there is evidence of inflation expectations having become more sensitive to changes in consumer prices after the post-pandemic inflation surge, thereby increasing the risk of one-time price increases due to de-anchoring of inflation expectations (Coibion and Gorodnichecnko, 2025).

Given that the post-pandemic inflation surge was largely driven by demand-side factors, continued – and even accelerating – deficit stimulus could also have inflationary implications (Bergholt et al., 2024). As the economy has started to show signs of cooling, the Fed has clearly started to weigh more into its employment mandate by starting its rate cutting cycle. However, with headline inflation – and more concerningly core inflation – still stuck at around 3 % (well above the 2 % target) with no sign of fiscal consolidation, the Fed faces more trade-offs in the near future.[15]

Effects of eroding central bank independence on fiscal sustainability are hard to assess. With Trump's ceaseless criticism of Fed chairman Jerome Powell, observers increasingly worry about central bank independence. If the administration seeks to influence monetary policy, the most probable avenue would be through appointment of a chairman and governors sympathetic to administration goals. Two of the seven seats on the Fed Board come open for appointment during the current presidential term.[16]

Though the law on removing regional Fed governors is somewhat unclear and has never been tested in court, a sympathetic board could replace at will the regional

[14] See Are Businesses Absorbing the Tariffs or Passing Them On to Their Customers? Liberty Street Economics.
[15] This being the situation in December 2025 with the last CPI release being from September due to delays caused by the prolonged government shutdown.
[16] See Introduction to the Federal Reserve Board of Governors, Federal Reserve Bank of St. Louis.

Fed governors serving on the Federal Open Market Committee (FMOC).[17] A range of outcomes are possible if such changes lead to shifts in monetary policy priorities. First, and most importantly, inflation expectations could rise. This would raise especially interest rates for longer maturities. Together with widening deficits, an increase in the supply of US Treasury bonds would creating additional upward pressure on yields and add to future debt financing costs. However, as the monetary policy stance would ease, short yields would go down making the net effect more ambiguous. Rising inflation expectations feeding into inflation would also further devalue already existing debt, which could ease the federal debt load in real terms. The financial sector could also rebalance their asset portfolios and reserve holdings by diversifying out of the dollar. Major structural changes are unlikely however, as there is no clear single alternative to the dollar and the US Treasury bond market as a safe heaven.

The global effects of a widening Federal budget deficit depend largely on monetary policy reaction. If the Fed manages to effect independent monetary policy while reacting to inflation as usual, it is unlikely that large sudden effects befall on the global economy. However, if the Fed's grip on inflation is undermined, the resulting effects on US Treasuries could trigger contractionary effects globally. Additionally, as the US is running large trade deficits on goods, large movements in exchange rates induced by deteriorating central bank independence (rather than fundamentals of the real economy) could especially hurt export-driven economies, including SOEs.

4. Energy and climate

The Trump administration has pledged to expand US oil production and lower energy prices. Invoking the "Drill, baby, drill" battle cry on his first day in office, president Trump signed executive orders declaring a national energy emergency and roll-

[17] See Who has to leave the Federal Reserve next? Brookings.

backs in fossil fuel industry regulations. The promise of unleashing American oil and gas production, while bringing down inflation through energy prices, puts renewable energy and decarbonization efforts on a back foot. On January 20, Trump has issued an executive order temporarily withdrawing all permitting of federal wind projects in offshore areas on the outer continual shelf. In August, for example, the Bureau of Offshore Energy Management ordered a halt in construction of the nearly completed Revolution Wind Project off the coast of Rhode Island, only to have its order overturned a month later.[18] The administration also pulled out of the Paris Agreement on climate change.

A major expansion of US oil production is unlikely. The US, which regained its position as the world's largest oil producer in 2018, saw production hit an all-time monthly average high of 13,488,000 barrels a day in May 2025, according to the US Energy Information Administration (EIA). With global oil oversupply, prices have generally remained moderate throughout 2025. However, following the announcement of the reciprocal tariffs on April 2, oil prices fell as markets priced in rising recession fears.

With the exception of a brief spike during the Israel-Iran engagements, the price of US benchmark West Texas Intermediate (WTI) crude has remained below $65 dollars a barrel this year. The OPEC+ alliance of oil-producing countries notably boosted production during the first half of 2025.[19] With the weak demand outlook and increasing global supplies, it seems unlikely that US oil producers will feel the need to ramp up production at time soon, even if new capacity is freed up through more lax regulation. The Dallas Fed Energy Survey of 2025Q1 reports that US producers would need an average price of at least $65 dollars per barrel to profitably drill new wells.[20]

[18] The project also has been watched by foreign investors as it is led by the Danish Orsted company. See https://www.cnbc.com/2025/09/22/judge-orsted-revolution-wind-trump.html.
[19] OPEC+ includes OPEC members along with Azerbaijan, Bahrain, Brunei, Brazil, Kazakhstan, Malaysia, Mexico, Oman, Russia, South Sudan and Sudan.
[20] See Oil and gas activity edges higher; uncertainty rising, costs increase. Federal Reserve Bank of Dallas.

The administration has sought to undermine the Inflation Reduction Act. The Inflation Reduction Act of 2022 (IRA) was one of the most important legislative packages of Joe Biden's administration. Actions to dismantle the IRA are expected to raise electricity prices. Notable actions include the executive order titled "Unleashing American Energy" and Memorandum M-25-13, which halts all grants, loans, and financial assistance programs under the IRA until they have been reviewed.[21] In addition, citing claims of programmatic fraud and abuse, the Environmental Protection Agency (EPA) has terminated $20 billion in Greenhouse Gas Reduction Fund grants funded under the IRA. These actions have been challenged in court, resulting in the release of some of the grants.

While not outright repealing most of the IRA grants, deadlines for commencing construction to qualify for the clean energy grants have been preponed, risking a large part of the existing initiatives. This is exacerbated by the tightened foreign entity material assistance changes to the law. Estimates by the Rhodium Group project a rise in household electricity prices of 2–4 % relative to baseline by 2035 with the new legislation.[22]. Similarly, Bistline et al. (2023a, b) estimate 2.2 % and 5.4 % reductions relative to baseline by 2030 and 2040, respectively, because of the IRA.

Dismantling the IRA slows reduction of US carbon emissions. According to the EPA's multi-model analysis, IRA-induced reductions in carbon emission would be 43–48 % from the 2005 baseline by 2035, while a newer multi-model analysis brings this number to 34–44 %. This contrasts with a baseline reduction of 25–35 % without IRA measures. Most of these effects would result from decarbonization of electricity production. It is important to note that the net-zero emission target by 2050 set by the US as part of the Paris Agreement requires a 63 % reduction in emissions by 2035. According to the EPA, this target could be achieved if, in addition to the IRA, the administration and Congress moved to improve regulation of fossil fuel power

[21] See 100 Days of Trump 2.0: The Inflation Reduction Act. Climate Law Blog, Columbia Law School, Sabin Center for Climate Change Law.
[22] See What Passage of the "One Big Beautiful Bill" Means for US Energy and the Economy. Rhodium Group.

plants, reinstated incentives for purchases of electric vehicles, and imposed carbon fees. Unfortunately, there is little political appetite in the US for such changes.

Expansion of US natural gas production could increase emissions over the long run. Several recent studies delve into the short- and long-term effects of US liquified natural gas (LNG) booms on greenhouse emissions. Acemoglu et al. (2023) find that, relative to their benchmark, a boom in US LNG production lowers CO_2 emissions in the short run by crowding out coal, but increases them over the long run as lower LNG prices discourage innovation in clean energy. They further note that a simultaneous optimal policy consisting of a carbon tax and clean energy subsidies would reverse these negative effects.

Expansion of US LNG exports has more ambiguous effects. While Abuin (2025) comes to similar conclusions as Acemoglu et al. about an increase in US LNG exports, they also finds that a joint carbon cap-and-trade by the EU, UK and Japan goes a long way in mitigating long-term emission increases from a US LNG export boom. Moreover, a future policy reversal by the US would not mitigate the effects of an export boom today. The LNG infrastructure would be operational for decades to come, and thereby provide resistance to adoption of cleaner technologies.

Current climate decisions can have long-term effects on US and global emissions. International climate policy can mitigate these emissions even without US involvement. Given that global oil prices are currently relatively low, an immediate increase in US oil production seems unlikely. While an increase in US LNG exports could lead to sizable increases in clean energy production in the US, it also would increase global carbon emissions. Thus, the actual effects are largely dictated by future fossil fuel prices as these determine the profitability of energy infrastructure, as well as the relative size of increase in US production and export levels.

The literature also highlights two important factors. First, climate policies, even those later reversed, can have extremely longstanding effects. A US policy stance friendly to fossil fuels could lead to major increases in fossil fuel infrastructure that would remain in place for decades to come. In the worst-case scenario, it could have permanent effects on clean energy development. Acemoglu et al. (2023)

compare the current situation to other historical episodes where accidental developments led to permanent adoption of inefficient solutions. This was the case with Henry Ford's production decisions leading to internal combustion engines beating out early electric engines. Second, coordinated international policy can still have major positive impacts even with the US side-lined at the moment.

5. Deportations and immigration – a natural experiment in shrinking the labor force

The immigration surge of recent years has driven President Trump's agenda to conduct "the largest deportation operation in US history." Estimates suggest that there are currently approximately 15 million undocumented immigrants in the US (up from 11.6 million in 2022), which equals to around 3–4% of the US population. Most undocumented migrants come from Mexico, and Central and South America.[23] Rough estimates indicate that there were 8.3 million undocumented migrants in the labor force (approximately 5 % of total) in 2022, mostly working in construction, agriculture, leisure & hospitality, and manufacturing.[24] The first Trump administration and the Biden administration each deported around 1.5 million migrants.[25]

Trump's aggressive tactics to demonstrate his commitment to deportation and strict immigration policies test constitutional limits. Most noteworthy implications include 1) declaring a national emergency at the US-Mexico border, enabling the president to use funds without congressional approval and deploy the military; 2) the expansion of the Immigration and Customs Enforcement agency powers to bypass immigration courts and deport undocumented migrants from the entire country within two years of entering; 3) halting the processing of migrants and asylum-seekers at

[23] See What we know about unauthorized immigrants living in the U.S. Pew Research Center.
[24] See https://www.pewresearch.org/short-reads/2024/10/21/most-us-voters-say-immigrants-no-matter-their-legal-status-mostly-take-jobs-citizens-dont-want/
[25] See https://www.bbc.com/news/articles/clyn2p8x2eyo

the border and turning them away; and 4) pushing cases through to court to end the birthright citizenship (Wilson, 2024). This breaks the century old precedent of the interpretation of the 14th amendment of the constitution, which has prompted a series of challenges in federal courts[26]. In the first six months of the Trump administration, detentions and deportations increased, with the total number of 150,000 people deported. Monthly attempted crossings at the southwest border are reportedly 90 % lower than under the previous administration.[27]

Declining immigration and more deportations pose significant costs to the US economy and labor supply. Shrinking the labor force entails lower employment, lower economic growth, lower investment, higher inflation, and deeper fiscal deficits due to lower tax revenues (McKibbin et al., 2024). For example, the Dallas Fed estimates that a reduction in net unauthorized immigration would lower GDP growth by 0.8–1.0 pp in 2025, and by 0.5–1.5 pp in 2027, depending on the scale of deportations.[28] The impact on inflation is positive, but less pronounced, with annual inflation 0.1–0.2 pp higher. This adds to stagflationary pressures and complicates Fed decision-making. Deporting all undocumented workers would entail extremely severe costs, but this is highly unlikely due to logistical and resource constraints, as well as institutional checks and balances.

The imposition of restrictive measures on high-skilled authorized migrants and international students could reduce the US talent pool and hurt productivity growth. Recent changes include slow-walking student visas from countries such as China, limiting programs that enable international students to work in the US after graduation, and rejecting applications from skilled workers who wish to migrate or remain, including people in tech or science fields.[29]

[26] See: How birthright citizenship made it back to the Supreme Court - SCOTUSblog
[27] See History Made, Again: Trump Administration Crushes Border Records in July. Homeland Security.
[28] See https://www.dallasfed.org/research/economics/2025/0708.
[29] See Trump's Crackdown on Foreign Students Threatens to Disrupt Pipeline of Inventors. The Wall Street Journal.

Some universities faced pressure to reduce international student enrollments, with federal funding tied to compliance.[30] Studies from Stanford and the National Bureau of Economic Research show that immigrants contribute to more than a third of US innovation output, so restricting them could reduce US productivity growth by 3–5% over a ten-year period (Burchardi et al., 2020).[31] Reducing access to global talent impairs startup formation, AI leadership, and climate-tech competitiveness.

The increasingly restrictive immigration policies of the US pose both risks and opportunities for the EU. On the one hand, the US shift legitimize and embolden anti-immigration sentiment and policies, reinforcing populist pressure within Europe to restrict migration. The shift would be particularly problematic given the region's urgent demographic need for foreign workers to support pensions and economic growth in aging societies.[32] At the same time, US nativism creates strategic opportunities. Europe can provide an alternative to top international students and skilled workers discouraged or excluded by US policies. Programs like the European Commission's €500 million "Choose Europe for Science" aim to capitalize on this opening, enhancing the EU's position in global science, tech, and innovation fields.[33]

6. Financial markets – time to deregulate

Deregulation of the financial system is coming. The Trump administration has an overall theme of deregulation, and financial markets are no exception. Despite the possibility of excessive risk-taking, fraud, and instability, certain changes are widely anticipated. These include personnel changes in current financial regulators,

[30] See US universities' settlements with Trump 'will only fuel his authoritarian appetite' | US universities. The Guardian.
[31] See The Brain Gain: The Impact of Immigration on American Innovation. Stanford Graduate School of Business.
[32] See Europe's ageing societies require immigration to survive – and that means anti-immigration politics is here to stay. British Politics and Policy at LSE.
[33] See Europe pledges half a billion euros to lure scientists as Trump battles universities. Reuters.

reversal of some regulatory actions (the "Basel III endgame"[34] in particular), significant easing of the regulatory environment for banks, as well as deregulation of the cryptocurrency industry. These may have widespread implications for the global regulatory environment, and we may see more calls for simplification of rules also in Europe.[35] The deregulatory drive may also have implications and heighten potential risks to the EU financial sector.[36]

Personnel changes in key agencies are already leaving their mark. During the 2024 campaign, Trump said he would require various key officials to step down from their positions. Where possible, he has lived up to his promise, appointing interim heads to e.g. the Office of the Comptroller of the Currency (OCC), the Chair of Federal Deposit Insurance Corporation (FDIC), the Director of Consumer Financial Protection Bureau (CFPB), and the Chair of Securities and Exchange Commission (SEC).[37] Moreover, FDIC and SEC have been barred from proposing or issuing new rules by an executive order.[38] The former Fed Vice Chair for Supervision, Michael Barr, would have been the most controversial for Trump to demote, but Barr stepped down himself.[39] Barr, however, did not resign from the Fed Board of Governors, where his term does not end until 2032. Michelle Bowman, a vocal opponent of "excessive and over-calibrated" banking regulation, was confirmed as Barr's successor in June.[40] Bowman's first actions in the position indicate that she remains a supporter of a less-regulated banking sector and enhanced supervision.

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[34] "Basel III endgame" refers to final implementation of the Basel Committee on Banking Supervision's post-crisis package. Large US banks generally regard the Basel III rules as excessively burdensome without delivering stability and resiliency.
[35] See recent speech by Francois Villeroy de Galhau, Governor of the Banque de France and Chairman of the Board of Directors of the Bank for International Settlements, Towards a realistic simplification: untying some of the knots in European banking regulations. Banque de France.
[36] See Speech by Olli Rehn at the hearing of the ECON committee.
[37] See Rodney E. Hood Announced as Acting Comptroller of the Currency, Office of the Comptroller of the Currency; Travis Hill (bio), FDIC; Russ Vought, Acting Director, Consumer Financial Protection Bureau; Mark T. Uyeda Named Acting Chairman of the SEC, Securities and Exchange Commission.
[38] See Regulatory Freeze Pending Review. The White House.
[39] See Federal Reserve Board announces Michael S. Barr will step down from his position as Federal Reserve Board Vice Chair for Supervision, effective February 28, 2025, and will continue to serve as governor. Board of Governors of the Federal Reserve System.
[40] See e.g. Speech by Governor Bowman on bank regulation. Board of Governors of the Federal Reserve System.

The international regulatory environment for banks faces radical adjustments. The Basel III endgame has been stalled for some time now due disagreements over capital requirements. The 2023 July proposal by Fed, FDIC, and OCC, which was widely considered too strict, called for increases in capital requirements of almost 20 %, considerably more than the 1.5 % originally proposed by the Basel Committee Staff. In September 2024, Barr announced a significantly less onerous amended proposal calling for 9 % higher capital requirements.[41] It is likely that the final Trump nominations will push for at least as big an easing to the 2023 proposal, and possibly much more. Some elements of the regulations that most bother industry could be taken out or simplified. That said, most large international banks are lobbying for the implementation of Basel III as they are otherwise at a disadvantage compared to their European rivals.[42] Easing of stress testing requirements and scenarios, as well as shadow capital requirements, are also expected.[43] Finally, rules on mergers and consolidation of banks will likely be eased.

Crypto assets, including stablecoins, are likely to receive much more lax and favorable treatment. With the overall political establishment warming to crypto assets, there could be some bipartisan support for reforming crypto legislation. This, coupled with the apparent enthusiasm of Trump and his administration for crypto currencies, are likely to fuel a push for relaxed regulation. Trump has signed an executive order prohibiting the creation of a CBDC (central bank digital currency), and has established a working group tasked with producing a federal regulatory framework on issuance and operation of digital assets.[44] From a central banking perspective, the newly sworn in Vice Chair Bowman accused regulators of having an "overly cautious mindset," suggesting that the Fed could take a more supportive approach towards

[41] See: Speech by Vice Chair for Supervision Barr on Basel III endgame - Federal Reserve Board
[42] See: Capital neutrality key to completing Basel III, says Quarles - Central Banking
[43] See: What Trump's Second Term Means For Financial Services
[44] See: Trump says 'no' to CBDCs - Central Banking, Strengthening American Leadership in Digital Financial Technology, Fact Sheet: Executive Order to Establish United States Leadership in Digital Financial Technology – The White House

crypto. The economist Lucrezia Reichlin recently argued that the Trump administration may see crypto as a way to secure the dominant role of the dollar.[45]

7. Conclusions

The policy actions and plans of the second Trump administration promote protectionism and generate policy uncertainty. While the currently imposed and threatened tariffs are likely to have negative effects globally, modest effective tariff rates should be relatively easily offset by changes in exchange rates and tweaks to global value chains. Despite the size of tariffs discussed and implemented, global trade levels have remained surprisingly elevated. While the ultimate impact of tariffs hinges on the willingness of those affected to take President Trump's word at face value, the threat of tariffs creates uncertainty that is sure to depress investment and trade. The latest data from the US on retail, consumer confidence, inflation expectations, and PMIs all point to uncertainty starting to bite American consumers. Tariff costs passed along to prices have become part of America's "affordability" discussion.

Policy actions such as deportations face practical challenges and growing domestic opposition. As with the first Trump presidency, many central policy pushes were ultimately watered down. Yet even if deportations and tariffs have a major negative impact on the US economy, the growing fiscal support makes the short-term spillover effects to the global business cycle ambiguous. While the effects of individual policies remain highly speculative, the most obvious effects to the global economy are likely to result from increased uncertainty, the undermining of multilateralism, as well as heightened geopolitical and security risks.

Wild variation in consequences for the rest of the world, especially small open economies. Trade disruptions and increased exchange rate movements could harm export

[45] See Lucrezia Reichlin, Will Crypto Save the Dollar? Project Syndicate.

dependent economies. Similarly, tariffs and a cooling-down of the US economy could lower demand for exports in the rest of the world. Swings in US Treasuries could have consequences to the global financial system through reserve valuations if the administration's policy stance triggers such movements. Financial deregulation could have global implications as the financial system has become increasingly reliant on the US.

On the other hand, it is unclear whether uncertainty will hamper the global economy for long, or whether it will just adapt to the new normal and carry on. Similarly, the effects of tariffs could remain short-lived if international trade flows recalibrate to new norms. It is also unclear how the varying tariff rates might create relative winners and losers; some countries may be able to export their products at low rates relative to others. All in all, it is important to be aware of the potential mechanisms while recalling the resilience inherent to flexible market economies even when they confront large-scale change.

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