Tomorrow's Affairs
Analysis of today
Assessment of tomorrow

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Four Reasons Why the Market Correction Has Nothing To Do With Trump

Market corrections happen, and the temptation to blame it on the president of the United States rises exponentially when the person is Donald Trump.

However, market corrections have nothing to do with his policy announcements.

In 2016, Trump announced tax cuts, deregulation, government spending cuts and tariffs. In 2024, Trump also announced tax cuts, deregulation, government spending cuts and tariffs.

It makes no sense to blame the current administration after less than two months in office and ignore all the warning signs that built up in the past months.

Market busts always come because of the previous debt excess.

Five datapoints allow us to identify the real reason for the market correction.

Persistent inflation: Market participants are often hooked on easing policies because dovish central banks mean a higher money supply growth, lower rates, declining bond yields and equity multiple expansion.

However, if inflation soars, investors pull away from risky assets, expecting lower or no rate cuts and contraction in the money supply.

Inflation expectations in the United States began to rise in 2024 around mid-year, with significant shifts becoming evident by June. The Federal Reserve increased their 2024 inflation forecast to 2.6% from 2.4% in their 12 June 2024 projections.

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However, the Federal Reserve's policy was highly dovish. It panicked in June, when Treasury bond yields soared, and delayed its pace of normalisation of the balance sheet, effectively signalling a dovish stance that prioritised liquidity over inflation.

Furthermore, the Federal Reserve decided to cut rates in September despite persistent inflation.

The New York Fed's Survey of Consumer Expectations shows that median one-year-ahead inflation expectations remained relatively stable at 3.0% through much of early 2024 but began to edge up later in the year.

By the end of 2024, consumer expectations had surged to a 15-month high. By December 2024, the Consumer Price Index (CPI) hit 2.9%, with a 0.4% month-over-month increase, indicating a reacceleration. The 24% cumulative inflation of the past years was followed by inflation's stickiness—particularly in shelter and services—prompting a reassessment among consumers and businesses of the outlook for inflation.

Uncontrolled government spending and deficit: The Biden-Harris administration accelerated government hiring, spending and debt in an election year, creating a fiscal and monetary time bomb as well as perpetuating inflation.

The federal budget deficit for 2024 totalled $1.83 trillion, according to the U.S. Treasury Department's final Monthly Treasury Statement. This marked an increase of $138 billion (8%) from the $1.69 trillion deficit recorded in FY 2023, making it the third-largest deficit in U.S. history and the largest in a year of peace, with record tax receipts, employment and economic growth.

Federal debt reached a record $35.5 trillion by the end of FY 2024, a $2.3 trillion increase from FY 2023, according to the GAO's audit of the Bureau of the Fiscal Service's Schedules of Federal Debt.

Furthermore, gross interest expenses reached $1.126 trillion, up $251 billion from 2023, despite a dovish Federal Reserve containing bond yields.

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In the period between 2021 and 2024, government spending accounted for 24% of all economic growth (GDP) and government jobs soared by more than one million; spending rose by $2 trillion from the 2019 level and $617 billion (10%) in 2024 alone, reaching $6.752 trillion.

In the last months of 2024, reports of acceleration in government spending led to an $86.6 trillion 10-year spending plan (FY 2025–2034), according to the Congress Budget Office, with various senators claiming it front-loaded costs.

Debt accumulation: A dovish and confident Federal Reserve also led to market participants and consumers taking on more debt, expecting a steady path of rate cuts. The messages from the Federal Reserve changed from optimistic about inflation to cautious in the last months of 2024.

In markets, FINRA Investor Margin Debt reached $937.253 billion as of 1 January 2025, marking a record high and reflecting a year-over-year growth of 33.41%.

At the end of 2024, U.S. credit card debt reached a record high, reflecting a massive 13% increase throughout the year. According to the Federal Reserve Bank of New York, total credit card balances hit $1.21 trillion in the fourth quarter of 2024. This is a $45 billion increase from Q3 2024's $1.166 trillion. It marks a 3.9% quarterly rise and pushes the total to an all-time high since the New York Fed began tracking in 1999.

Fed goes from bullish to bearish: The Federal Reserve changed radically its tone from optimistic to a cautious stance on inflation towards the end of 2024, with this shift becoming particularly evident around November 2024 and solidifying by December 2024.

This caution fully took hold by 18 December 2024, with the revised projections and Powell's explicit statements.

Trump may have arrived when the bubble burst, but he did not create it - Daniel Lacalle

This shift marked a transition from a rate-cutting cycle initiated in September to a more deliberate, wait-and-see approach as 2025 loomed.

The time bomb was already set. Soaring government spending, federal and private debt, expecting various rate cuts in 2025, and a 180-degree policy change regarding interest rates in the last two months were aligning alongside an expensive market, as the valuation of the S&P 500 and Nasdaq reached 22 and 32 times, respectively, close to 20% above its average in the case of technology names.

Furthermore, the market was heavily concentrated in its returns. Five stocks—NVIDIA, Microsoft, Apple, Amazon, and Alphabet—contributed approximately 42–47% of the S&P 500's 2024 market increase.

What caused the current correction is a combination of irresponsible fiscal policy driving debt to new heights. Misguided guidance from the Federal Reserve pushed private and market participants debt to record highs, expecting an easy and rapid disinflation process. This would lead to lower rates and more liquidity.

The Biden administration bloated economic growth and job gains with federal spending and debt. The Federal Reserve contributed to the excess panicking by cutting rates too much and too fast and delaying its balance sheet normalisation to try to limit the impact of the irresponsible fiscal policy on Treasury yields. The result was a perfect storm.

The Fed went hawkish, debt continued accelerating, and the economic slowdown, which was already evident in the last three quarters of 2024, all erupted at once when the market exuberance was pricked by two catalysts.

The Tech sell-off caused by the overblown Chinese artificial intelligence impact and the reduction in risk required by investment firms' risk management teams to accommodate for a reality of persistent inflation and higher rates.

Trump may have arrived when the bubble burst, but he did not create it.