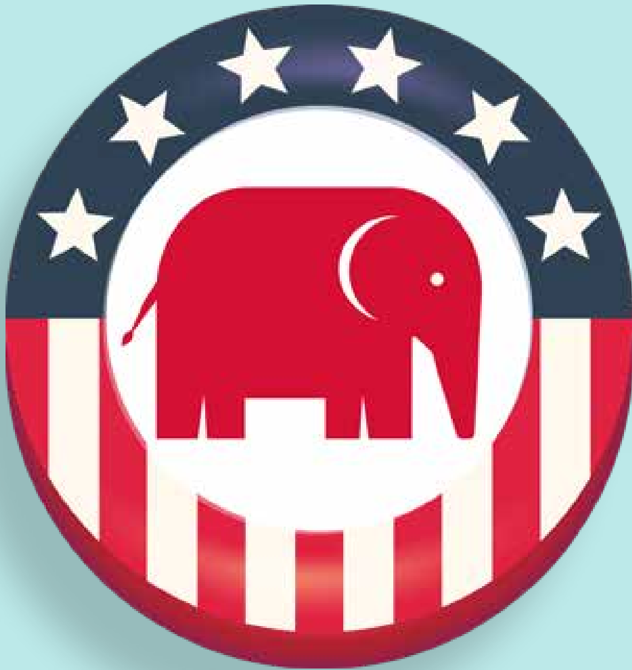
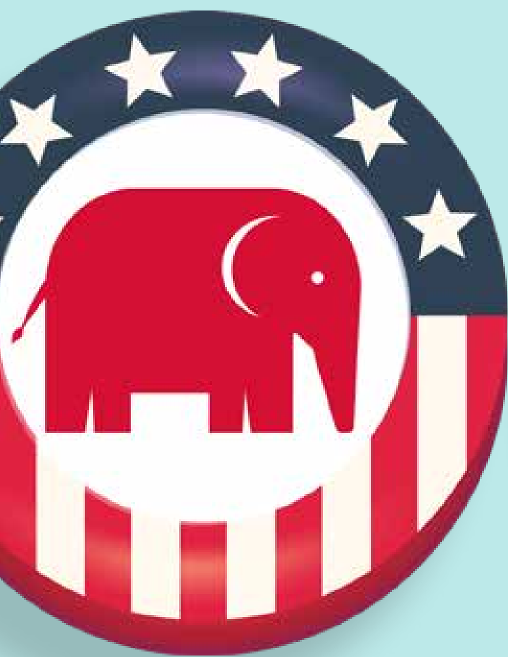
BBH

FOREIGN EXCHANGE

2024 FOURTH QUARTER OUTLOOK



Special Election Edition



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A looming election, expected Fed cuts, and global easing cycles

US economy remains strong with cautious Fed and as global economies continue rate cuts

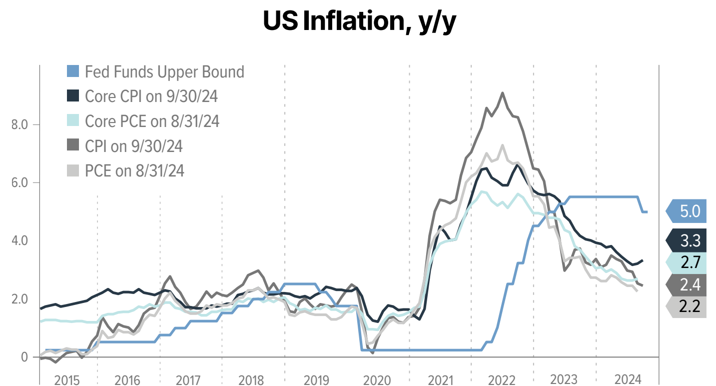
Insights from Win Thin

Market expectations for aggressive Fed easing have been knee-capped by the strong September jobs report. A 50 bp cut in either November or December has now been completely priced out and a 25 bp cut next month is now only 80-90% priced in. Despite this most recent batch of strong data, the markets are still pricing in 125 bp of total easing over the next 12 months. Rates continue to fall and needs to adjust even further as UST yields have risen across the board and the 10-year is trading above 4% for the first time since August.

US Yields, %

The Fed doves have been silenced. After the jobs data, Chicago Fed President Goolsbee stopped calling for "a lot more easing" over the next year. In hindsight, Governor Bowman's lone dissent against the Fed's 50 bp cut last month looks prescient and we expect most Fed officials to follow her more cautious view.

US Inflation, y/y



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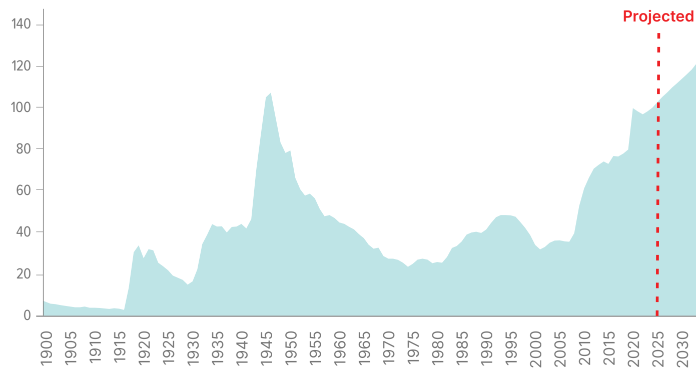
The Fed's latest dot plots seem too dovish now. The median dot for 2024 sees two more 25 bp cuts, followed by four in 2025 and two in 2026. The recent jobs report indicates the US economy remains quite robust and won't require aggressive easing. The Atlanta Fed's GDPNow model is tracking Q3 growth at 3.2% SAAR vs. 3.0% SAAR in Q2. The New York Fed's Nowcast model is tracking Q3 growth at 3.1% SAAR and Q4 growth at 2.8% SAAR. Momentum in the economy remains strong and little slowdown is likely heading into 2025.

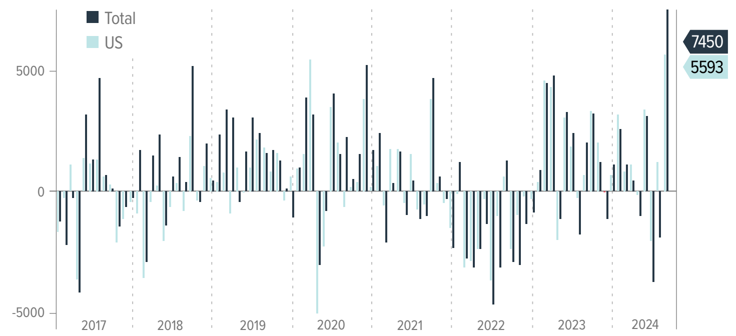
NY Fed Nowcast GDP Estimate, % seasonally adjusted annual rate (SAAR)



Bank of Japan forced to become more dovish. Despite market reaction to its hawkish surprise in July, economic data has softened and Governor Ueda has taken pains to present a more dovish policy stance. August cash earnings data was weak, with real earnings turning negative once again. The market is not pricing in the next BOJ hike until well into 2025. Furthermore, only 25 bp of total tightening is seen over the next 12 months.

Recent account data showed large capital outflows from Japan. Japan investors became a total net buyer of foreign bonds (JPY7.450 trln) in August, the most since September 2007. The bulk went into US Treasuries. With the uptrend in Japan yields interrupted by the BOJ's dovish pivot, it's likely that Japan investors will continue chasing higher yields abroad. As a result, we believe USD/JPY is unlikely to trade at lows below 140 soon and see risks that it trades above 150 in the coming months.

Japan Bond Flows, JPY bln



Monetary policy divergences are alive and well. Besides the less hawkish Fed story, a soft economic outlook is driving a more dovish ECB, BOJ, BOE, and SNB. The same holds for the Riksbank, RBNZ, and BOC with RBA and Norges Bank eventually capitulating. Meanwhile, EM central banks for the most part continue to cut rates aggressively.

Bottom line: these policy divergences should continue to move back in favor of the dollar.

2-year Yield Differentials, bp

Europe: More Easing in the Pipeline

The European Central Bank (ECB) has already trimmed rates 50 bp so far this year to 3.50% and has room to dial-up easing as the eurozone economy stagnates (despite inflation undershooting the 2% target). In September, the Eurozone composite PMI fell below the 50 boom/bust threshold to a seven-month low of 49.6 while headline CPI inflation eased to 1.8% y/y, the lowest since April 2021. The market is pricing in 150 bp of total easing over the next 12 months that would see the policy rate

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bottom near 2.0%.

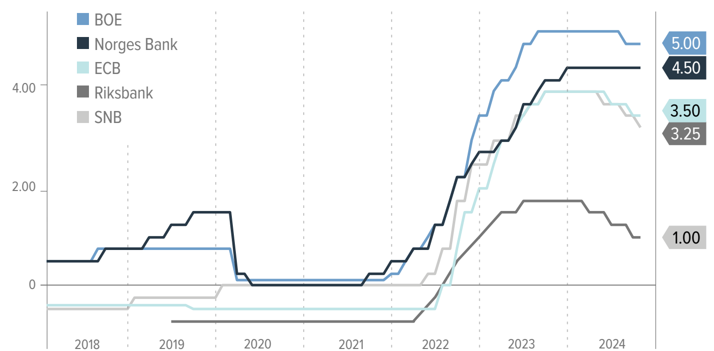
Switzerland The Swiss National Bank (SNB) was the first major central bank to cut rates in March, followed by 25 bp cuts in June and September to 1.00%. The risk is if the SNB slashes rates 50 bp at the December meeting as inflation undershot the SNB's Q3 projection of 1.1%. In September, headline CPI fell -0.3% m/m, while the y/y rate fell to 0.8% vs. 1.1% in August. The market is pricing in 50 bp of total easing over the next 12 months, bringing the policy rate bottom near 0.5%.

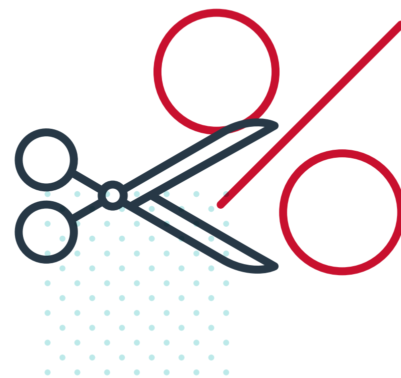
Sweden Riksbank, the second of the major central banks to cut back in May, followed up with 25 bp cuts in August and September to 3.25% as disinflationary pressures quickened. The market is pricing in 150 bp of total easing over the next 12 months that would see the policy rate bottom near 1.75% (2.25% lower than the Riksbank's projection). Unless inflation cools more than expected, there is room for interest rate futures to converge towards the Riksbank's policy rate forecast.

England The Bank of England (BOE) kicked off its easing cycle in August with a 25 bp cut to 4.75%. Widely expected to cut the policy rate 25 bp at the November 7 meeting, the odds of a follow-up 25 bp cut in December are around 60%. BOE Governor Andrew Bailey held out the prospect of the Bank becoming a "bit more aggressive" in cutting interest rates provided positive inflation news. However, the pick-up in UK leading economic indicators and sticky service price inflation suggest the threshold for an aggressive BOE easing cycle is high. The market is pricing in 125 bp of total easing over the next 12 months that would see the policy rate bottom near 3.75%.

Norway Norges Bank continues to buck this year's global easing trend. The bank has held the policy rate steady and reiterated in September that "the policy rate will likely be kept at 4.5 percent to the end of the year." With the weaker krone exchange rate, the Norges Bank has a first full 25 bp cut pencilled-in for Q2 2025 while markets have virtually fully priced in a rate cut at the January 23 meeting. Norges Bank risks easing sooner rather than later because mainland economic growth is sluggish and underlying inflation is easing rapidly. The market is pricing in 100 bp of total easing over the next 12 months followed by another 25 bp over the subsequent 12 months leaving policy rate bottom near 3.25%.

European Policy Rates, %





EMERGING MARKETS GLOBAL OVERVIEW

China's looming debt and emerging markets cautious outlook

Insights from Win Thin

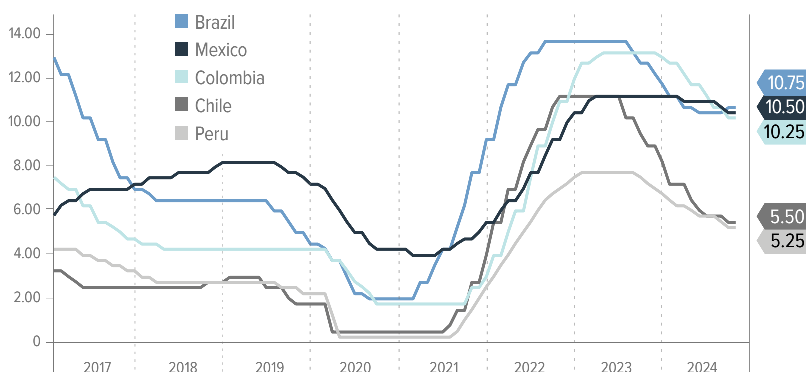
China is in stimulus mode. Money and new loan data are expected to pick up modestly in the coming months after the latest measures. In this most recent round, PBOC cut the policy-relevant 7-day reverse repurchase rate 20 bp to 1.50%, slashed banks' reserve requirement ratio by 50 bp, reduced the down payment ratio on second homes to 15% from 25%, lowered rates for existing mortgages, and increased central bank support for buying unsold homes. We believe the fiscal stimulus funded by more debt will only worsen the large debt overhang that is the root problem in China.

China Money and Credit, y/y

We remain cautious on emerging markets. We expect emerging markets to continue cutting rates aggressively to stimulate domestic demand. Latin America has been aggressively cutting the rates reflecting aggressive tightening cycles seen in most of the countries in the region. Due to a poor fiscal outlook, Brazil's central bank has been forced to hike rates. Some countries in EMEA, such as Hungary, have cut aggressively, but most have been more cautious.

Emerging Asia has been the most cautious, with regional easing cycles only just beginning in the last month or two in Indonesia and the Philippines. Korea and India are next in line to cut. With the Fed likely to be much less dovish than the market expects, narrowing interest rate differentials are likely to weigh on EM FX.

LatAm Policy Rates, %



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SPECIAL SECTION

What the US election outcome could spell for financial markets

Insights from Win Thin and Elias Haddad

BBH Market Strategists Win Thin and Elias Haddad note what a Donald Trump or Kamala Harris presidency could mean for US financial markets, as well as trade, fiscal, and industrial policies.

The US election remains too close to call ahead of the November 5 vote, but analysis of "Trumpenomics" vs "Kamalanomics" is well underway. A divided Congress is the most likely scenario in our view. The political gridlock will make it difficult for the next president to implement major fiscal changes, meaning fiscal policy will remain a drag to growth in the next few years.

Trumpenomics bottom line: fiscal and trade policies under a Trump presidency are inflationary. This could force the Fed to keep the policy rate restrictive for longer, underpinning a firmer USD and Treasury yields. Nonetheless, Trump's ambiguous currency policy is a major headwind for the dollar.

Kamalanomics bottom line: fiscal and trade policies under a Harris presidency are less likely to complicate the Fed's price stability mandate, supporting a neutral outlook for USD and Treasury yields.

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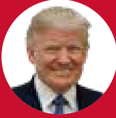
A deeper dive

We look at each candidate's economic platforms and how those set the stage for potential financial market moves.



Trump - Bring business back to the US

Trump's description of his economic agenda is to "bring business back to our country". He plans to do so via tax cuts, more tariffs, and looser regulatory policies.

Extend and expand tax cuts: US think tank The Brookings Institution estimates that extending the 2017 tax cuts[1] will cost an extra USD$3.8 trillion over the next ten years. Elsewhere, the Congressional Budget Office (CBO) estimates that extending the 2017 tax cuts would cost USD$4.6 trillion over the next ten years. Trump is also pushing new tax cuts, such as exempting tips from taxation. The Committee for a Responsible Federal Budget estimates that doing so would cost USD$100 to USD$200 billion over the next ten years.

Trade/tariffs: Trump has floated plans for a 10% tariff on all imported goods. He has also proposed an even higher tariff rate of 60% on Chinese imports. The US imports about USD$3 trillion of goods each year, so a 10% tariff would yield roughly USD$300 billion in revenue. This is certainly not enough to cover Trump's proposed tax cuts.

In fact, studies show that tariffs are mostly passed on to consumers. Estimates for the average annual cost to households from the 10% across the board tariffs range between USD$1500 and USD$1700. From a macro perspective, most estimate that these tariffs would shave 0.5-0.7 percentage points off growth while adding 0.7-1.1 percentage points to inflation. However, most estimates don't factor retaliatory tariffs by the main trading partners, which would likely lead to a greater drag on growth.

Regulatory: Trump plans to loosen environmental regulations on the energy sector; he has also said he would loosen regulation and oversight of tech companies. A President can amend regulations by Executive Order without congressional approval.

According to a New York Times analysis from January 2021 that was based on research from Harvard Law School, Columbia Law School, and other sources, nearly 100 environmental rules were reversed during the Trump years[2].

Harris - Building up the middle class

According to Harris, a defining goal of her presidency is "building up the middle class."

Tax credits, subsidies, home-buyer support and lower healthcare costs: Harris has begun to unveil her economic platform which includes:

- Expanding the Child Tax Credit;
- Expanding the Earned Income Tax Credit;
- Extending the enhanced Affordable Care Act subsidies;
- Providing down payment support for qualified first-time homebuyers; and
- Lowering prescription drug costs.

It's not yet clear how these new spending measures would be funded, but judging from her recent statements they would like resemble President Joe Biden's 2025 budget proposal.

The Penn Wharton Budget Model estimates that the Harris Campaign's tax and spending proposals would increase primary deficits (deficit less interest payments on the debt) by $1.2 trillion over the 2025-2034 budget window. Meanwhile, the Committee for a Responsible Federal Budget projects Harris's policies would raise primary budget deficits by between $1.7 and $2.0 trillion over the next decade.

Trade/tariffs: The Biden-Harris Administration 2024 trade policy agenda emphasizes a continued commitment *"to a fair and open global trading system"* and calls for *"using trade as a force for good."* Moreover, the Administration aims for a trade relationship approach with China that is *"holistic and pragmatic"* instead of an across-the-board adoption of tariffs.

Of note, the Biden administration has kept most of the Trump administration's tariffs in place. In fact, Biden announced tariff hikes in May 2024 on an additional $18 billion of Chinese goods, including semiconductors and electric vehicles that generated an additional $3.6 billion of tariff revenues.

Regulatory: Harris wants to cap prescription drug prices. She also plans to direct the Federal Trade Commission (FTC) and other agencies to investigate and penalize corporations for unfair price-fixing.

Trade/tariffs state of play

Section 232 of the Trade Expansion Act of 1962 allows the President to bypass Congress and impose tariffs if certain imports threaten to impair US national security.

1 https://www.cbo.gov/publication/60039

2 These include rules on air pollution and emissions, drilling and extracting, water pollution, toxic substances, and safety. The bulk of these rollbacks sought to weaken Obama-era policies.

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Trump	Harris
Monetary policy: Trump believes the president should have influence in setting monetary policy. Specifically, at a press conference on August 8[3], he said "I feel the president should have at least have (a) say in there, yeah, I feel that strongly." This follows reports earlier this year that a team of Trump's allies were drafting plans to erode the Fed's independence if Trump were to win the election. Trump walked that back on August 19 and said "I think it's fine for a president to talk. It doesn't mean that they have to listen."[4] Trump recently said that he would not replace Fed Chair Jay Powell before his term ended. Of note, Trump appointed Chris Waller and Michelle Bowman to the board during his term. Since Powell's replacement as Chair would be chosen from the existing Board of Governors it remains virtually impossible for a sitting president to influence monetary policy under the current Fed structure.	**Monetary policy:** Harris believes in maintaining the independence of the Fed. On August 10, she told reporters that she could not disagree "more strongly" with Trump's view on Fed independence and that she would "never interfere in the decisions that the Fed makes." [5]

Monetary policy state of play

Changes to the Fed's mandate or structure require congressional approval. The Fed Board of Governors explicitly states that "Elected officials and members of the Administration are not allowed to serve on the Board."

Presidents can only impact Fed policy indirectly by their appointments to the Board of Governors and as Fed Chair. In that regard, Fed Chair Jay Powell's term ends May 2026.

It's worth noting that if he is replaced as Chair, Powell would remain on the Board of Governors until January 2028.
Kugler's term on the board ends January 2026. These two will be the only opportunities for the next president to appoint new Governors.

Trump	Harris
Dollar policy: Judging from recent comments, Trump would like to weaken the dollar. A weaker dollar would increase the costs of imports and, like tariffs, are likely to be passed on to the consumers. A weaker dollar could also lead foreign investors to demand higher returns to hold dollar denominated assets due to increased currency risks, which raises costs for the Treasury. In a July interview with Bloomberg Businessweek[6], he emphasized "we have a big currency problem because the depth of the currency now in terms of strong dollar/weak yen, weak yuan, is massive." Trump's running mate JD Vance added "devaluing of course is a scary word, but what it really means is American exports become cheaper, and that's important." Trump's former US Trade Representative Robert Lighthizer is thought to be one of the top picks to become Treasury Secretary. In his 2023 book "No Trade Is Free," Lighthizer wrote that it is "clear" that the dollar is "well overvalued" and that the US could make a number of moves to correct that.	**Dollar policy:** Harris has not opined on the dollar. However, we expect her pick for Treasury Secretary to take the same stance as Larry Summers, Timothy Geithner, and others right up to Yellen now did in following Robert Rubin's lead in their stance that a strong dollar is in the best interests of the US.

Dollar policy state of play

Exchange rate policy is run by the Treasury Department. However, with
market-determined exchange rates, Fed monetary policy is a major driver for the dollar.

A weaker dollar would increase the costs of imports and, like tariffs, are likely to be passed on to the consumers.

Past US administrations and effects on financial markets

Since major currencies began to float against each other in 1973, shortly after the collapse of the Bretton Woods System, the dollar benefitted the most under a Republican president, a Republican Senate, and a Democratic House. The dollar performed poorly when Democrats or Republicans held a trifecta[7] (see **tables 1 and 2**).

3 https://www.politico.com/news/2024/08/08/trump-fed-powell-bank-2024-elections-00173299
4 https://www.bloomberg.com/news/articles/2024-08-19/trump-defends-fed-criticism-weighs-providing-aid-to-home-buyers?sref=eeq6exxF
5 https://www.reuters.com/world/us/harris-says-fed-is-independent-she-would-never-interfere-its-decisions-2024-08-10/
6 https://www.bloomberg.com/features/2024-trump-interview-transcript/
7 "Trifecta" refers to the US Presidency and a majority in both houses of Congress.

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Table 1

US Administrations					
Periods	**President - Party Affiliation**	**Senate**	**House of Representatives**	**S&P 500 (%)**	**USD* (%)**
Jan 1973 - Jan 1975	Gerald Ford - Republican	Democrats	Democrats	-21	2
Jan 1975 - Jan 1977		Democrats	Democrats	29	6
Jan 1977 - Jan 1979	Jimmy Carter - Democrat	**Democrats**	**Democrats**	0	-3
Jan 1979 - Jan 1981		**Democrats**	**Democrats**	25	4
Jan 1981 - Jan 1983	Ronald Reagan - Republican	Republicans	Democrats	6	16
Jan 1983 - Jan 1985		Republicans	Democrats	14	16
Jan 1985 - Jan 1987		Republicans	Democrats	27	-2
Jan 1987 - Jan 1989		Democrats	Democrats	9	1
Jan 1989 - Jan 1991	George H.W. Bush - Republican	Democrats	Democrats	13	7
Jan 1991 - Jan 1993		Democrats	Democrats	19	7
Jan 1993 - Jan 1995	Bill Clinton - Democrat	**Democrats**	**Democrats**	6	6
jan 1995 - Jan 1997		Republicans	Republicans	30	3
Jan 1997 - Jan 1999		Republicans	Republicans	31	7
Jan 1999 - Jan 2001		Republicans	Republicans	3	4
Jan 2001 - Jan 2003	George W. Bush - Republican	**Republicans**	**Republicans**	-15	1
Jan 2003 - Jan 2005		**Republicans**	**Republicans**	17	-7
Jan 2005 - Jan 2007		**Republicans**	**Republicans**	11	-1
Jan 2007 - Jan 2009		Democrats	Democrats	-17	1
Jan 2009 - Jan2011	Barack Obama - Democrat	**Democrats**	**Democrats**	19	-5
Jan 2011 - Jan 2013		Democrats	Republicans	10	0
Jan 2013 - Jan 2015		Democrats	Republicans	21	7
Jan 2015 - Jan 2017		Republicans	Republicans	7	8
Jan 2017 - Jan 2019	Donald Trump - Republican	Republicans	Republicans	8	-1
Jan 2019 - Jan 2021		Republicans	Democrats	24	-2
Jan 2021 - Jan 2023	Joe Biden - Democrat	**Democrats**	**Democrats**	3	5
Jan 2023 - to date		Democrats	Republicans	28	1

Note: Bold denotes period when Party in the White House and Congress are the same. * Fed trade-weighted nominal broad dollar index.
Past performance does not guarantee future results.

Table 2

Average annualized return return:	S&P 500 (%)	USD* (%)
When Democrats have White House and Congress	11	1
When Democrats have White House and Senate. House is Republican.	20	3
When Democrats have White House and House. Senate is Republican.	n/a	n/a
When Democrats have White House but Congress is Republican.	18	6
When Republican have White House and Congress	5	-2
When Republican have White House and Senate. House is Democrat.	18	7
When Republicans have White House and House. Senate is Democrat.	n/a	n/a
When Republicans have White House but Congress is Democrat	5	4

* Fed trade-weighted nominal broad dollar index.
Past performance does not guarantee future results.

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For the S&P 500, the highest returning partisan control combination has been a Democratic President/Democratic Senate/Republican House. The S&P 500 performed equally well under a Democratic President/Republican Congress or Republican President/Republican Senate/Democratic House mix.

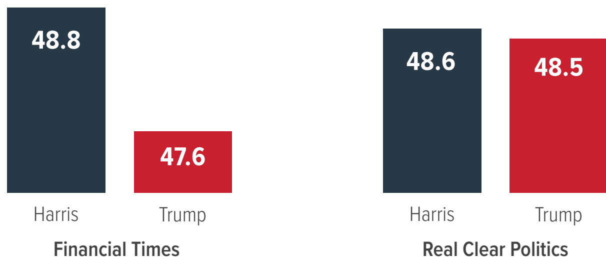
The races are on

Presidential race

It takes 270 electoral college votes to win the presidential election. In 2020, President Joe Biden won with 306 votes versus 232 for Trump. Biden also secured a majority of the popular vote with 51.3% versus 46.8% for Trump.

Up until Biden announced he would leave the race on July 21, national polling average favored Trump to win in 2024 by a margin of about 3 percentage points. Polling momentum shifted against Trump by as much as 3 percentage points after Harris was tapped as the official Democratic presidential nominee. But the latest national polling average shows Trump significantly narrowing the gap with Harris (**Chart 1**)[8] while betting odds are heavily skewed in Trump's favor.

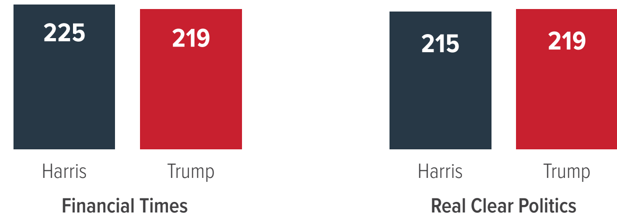
Chart 1



Last updated October 25.

More importantly, the path to 270 electoral college votes is shaping-up to be a nail-biter. Some polls show Harris has slightly more states either solidly in her corner or leaning in her direction. Other polls show Trump with the electoral college vote edge (**Chart 2**). Meanwhile, Trump has a narrow lead – within the margin of error – in virtually all the seven key battleground states that total 93 electoral votes (**Chart 3**).

Chart 2



*Include states that are either solid or leaning towards Harris or Trump. Last updated October 25.

Chart 3

Battleground States (As of September 19)	Electoral College Votes	Average Poll Margin (pct pts)	
		Financial Times	Real Clear Politics
Pennsylvania	19	Trump +0.3	Trump +0.6
North Carolina	16	Trump +1.5	Trump +0.8
Georgia	16	Trump +1.5	Trump +2.2
Michigan	15	Harris +0.5	Trump +0.2
Arizona	11	Trump +1.7	Trump +1.5
Wisconsin	10	Trump +0.4	Trump +0.2
Nevada	6	Trump +0.3	Trump +0.7
Total	**93**		

Senate race

It takes 51 seats or 50 seats plus the vice presidency to control the Senate. Democrats currently have majority control of the Senate with 51 seats versus 49 seats for Republicans. In the upcoming election, Republicans are considered to have a fundamental advantage as Democrats are defending 23 of the 34 seats up for 2024.

Republicans can take control of the Senate with a net gain of two seats or with a net gain of one seat and winning the 2024 presidential election. According to the website racetothewh.com, Republicans have a 61.1% chance of winning a majority in the Senate while Democrats have a 38.9% chance.

House race

It takes 218 seats to control the House of Representatives. Republicans currently have majority control of the House with 220 seats versus 212 seats for Democrats. According to the website racetothewh.com, Democrats have a 69.9% chance of winning a majority in the House while Republicans have a 30.1% chance.

8 Data as of October 25, 2024

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America's escalating fiscal burden

Regardless of the election outcome, the US public debt trajectory will not improve. Under current policies, the Congressional Budget Office (CBO) projects the federal debt to balloon from currently 97% of GDP to a record high of 122% of GDP in 2034.

The most effective way of bringing down high public debt ratios is by running primary budget surpluses. Unfortunately, the policies of both presidential candidates and government division make the prospect of a sustained debt adjustment very unlikely.

For now, investors remain largely unfazed by the chronic US fiscal imbalance. Foreign holdings of US Treasuries surged to an all-time high of $7.35 trillion in August and the compensation investors require for holding long-dated Treasuries (the term premium) has been broadly negative the past few years.

Indeed, the risk of sovereign stress in the US is low. As the IMF points out, US public debt is manageable, underpinned in large part by the strength of institutions, the depth of the investor pool, and the role of the US dollar in the international system.[9]

9 Pg11 https://www.bbh.com/content/dam/bbh/external/www/investor-services/insights/fxq2-2024/2024-6340807034-IS-FXQ2-PUB.accessible.pdf

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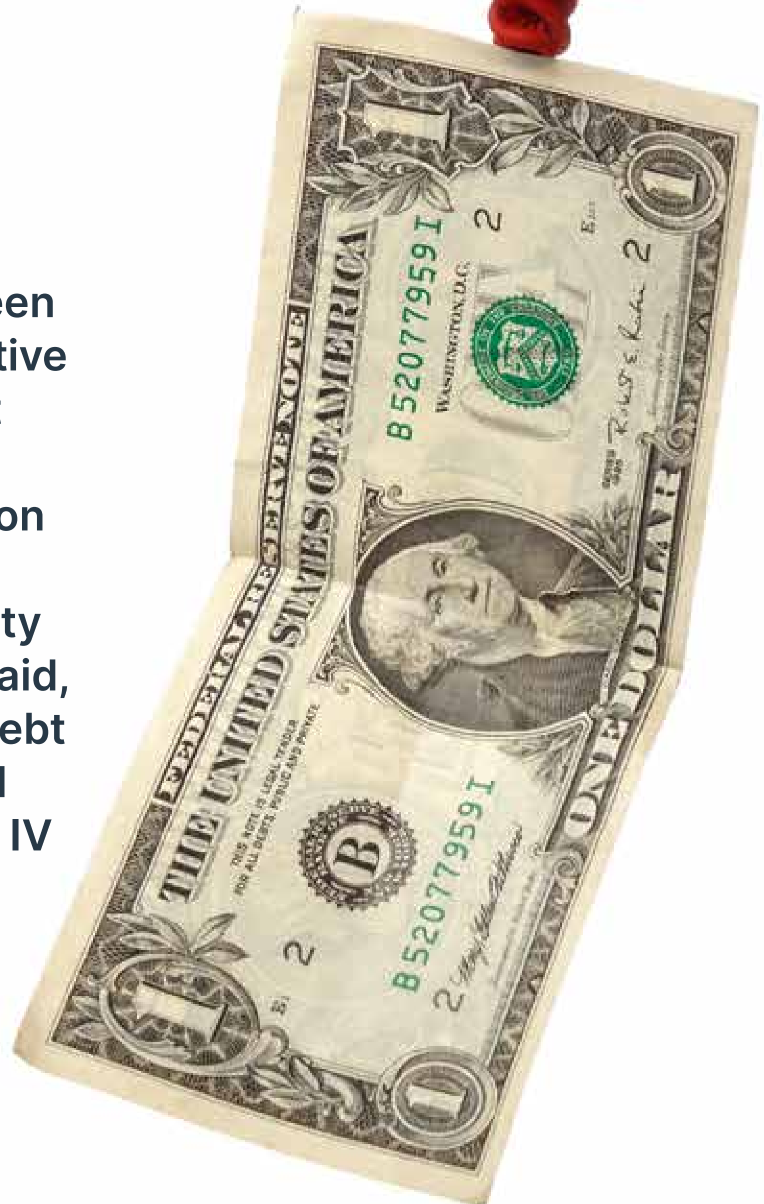
SPOTLIGHT:

Will the US Government Harness Ballooning Debt?

Insights from Jay Foraker

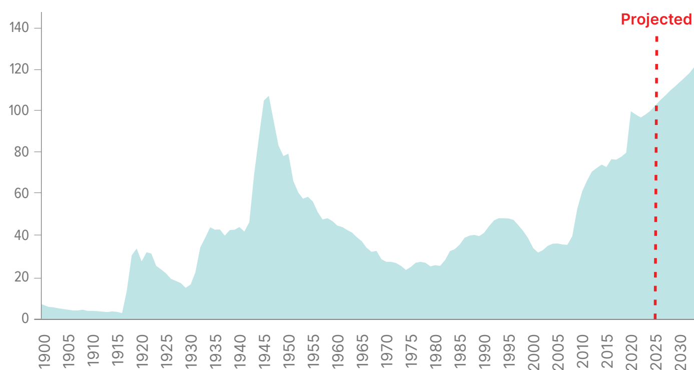


The 2024 election cycle has been notable for its void of constructive dialogue about US federal debt and deficit reduction, and even more notable for the proliferation of budget-stressing proposals emanating from both major party presidential candidates. That said, concrete solutions for deficit/debt reduction were recently shared by the IMF in their 2024 Article IV Review of US sovereign credit.

Background

No election year rhetoric can escape the fact that the US public debt trajectory continues to deteriorate. According to the Congressional Budget Office, regardless of the election outcome, the US federal debt is expected to expand from 97% of GDP currently to a high of 122% of GDP by 2034), surpassing the previous all-time high of 106% of GDP in 1946 (Figure 1).[1]

Figure 1: US Federal Debt Held by the Public
(% of GDP)

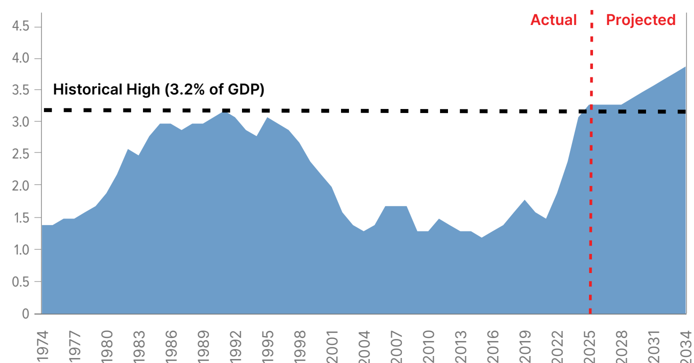


Source: https://www.cbo.gov/publication/60039

The US faces rising health and social spending needs as a portion of federal government expenditures, resulting from an aging society, along with increasing costs to service debt from rising interest rates. According to the Committee for a Responsible Federal Budget (CRFB), in May 2024 spending on net interest reached $514 billion, surpassing spending on both national defense ($498 billion) and Medicare ($465 billion).[2]

The US will spend 3.3% of GDP in 2025 on net interest (Figure 2), and this is projected to increase over the next decade. This represents the highest such level since net interest last peaked at 3.2% of GDP in 1991. This critical juncture should cause the next administration to pause and consider if the benefits of added fiscal stimulus are now reaching counter-productive levels, given the opportunity cost of funds spent on interest, as well as crowding out of private investment and potentially increasing inflationary pressures. Indeed, as we go to press, borrowing costs for the US government continue to climb as 10-year Treasury yields rose to near a three-month high around 4.30%, portending higher future interest rates in the face of persistently high deficits.

Figure 2:[3] Net Interest Outlays
(% of GDP)



Source: https://www.pgpf.org/budget-basics/what-are-interest-costs-on-the-national-debt

2024 Campaign Promises

The Harris and Trump campaigns have both made proposals which, on net, add to US fiscal deficits. Even when assuming the "central" of mid-range cost estimates by the CRFB,[4] the estimates are high when considering that the US economy is in a strong, peacetime stance, relatively speaking.

Harris' proposed federal outlays support first-time homebuyers and long-term caregivers, as well as forgone revenue in the form of extensions of the 2017 tax cuts (under the Tax Cuts and Jobs Act, or TCJA) for households <$400k, the Child Tax Credit, and the Earned Income Tax Credit. Central estimates that the Harris proposals will add net $3.5 trillion to the federal deficit over the next decade.[5]

1 https://www.cbo.gov/publication/60039
2 https://www.crfb.org/blogs/interest-costs-just-surpassed-defense-and-medicare
3 https://www.pgpf.org/budget-basics/what-are-interest-costs-on-the-national-debt
4 https://www.crfb.org/papers/fiscal-impact-harris-and-trump-campaign-plans
5 https://www.imf.org/en/Publications/CR/Issues/2024/07/18/United-States-2024-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-by-the-552100

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The Trump campaign, with respect to foregone revenue, extends and modifies the TCJA, ends or exempts taxes on social security, overtime wages and tips, and additional outlays are prioritized for defense and border security. These proposals are estimated to add net $7.5 trillion to the federal deficit over the next decade.

The IMF's Annual Review and Feedback

In the IMF's annual Article IV review of US economic developments and policies the US received kudos for rapid job growth and a return of real incomes to pre-pandemic levels. Despite noting the low risk of US sovereign stress, the IMF indicated the US has a "pressing need for a frontloaded fiscal adjustment" and made three observations on the U.S. fiscal situation:

– Fiscal realignment needs to go beyond adjustments to discretionary spending.

While such appropriations attract heavy attention during Congressional debt-ceiling standoffs, their composition of total federal outlays is comparatively light, at 27% total, or only 15% excluding defense spending.[6]

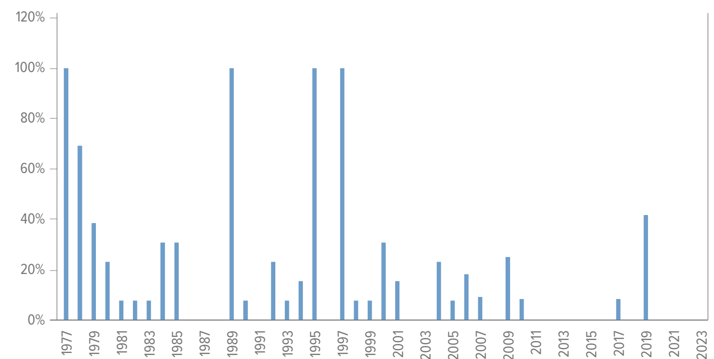
– The expiration of the 2017 tax cuts (TCJA) is an opportunity to engage in a broader societal discussion about the need for tax reforms.

Both campaigns have taken sharply contrasting positions to TCJA expiration (broadly, Harris to amend and Trump to extend) as core planks of their economic platforms.

– Increase efforts to "address shortcomings in fiscal institutions" that periodically lead to political standoffs over the debt limit and funding the federal government.

According to Pew Research, Congress has only passed all of its appropriations on time in four fiscal years since 1977, as shown in Figure 3.[7] The IMF sees this tendency as one which creates "systemic risks to the US and global economy that are entirely avoidable."

Figure 3: % Regular Appropriations Bills Enacted by Deadline



The IMF's proposed strategies to lower the US federal debt are further outside the mainstream of current US candidates or voters' appetites, including:

– Scaling back popular tax expenditures such as deductibility for state and local taxes and mortgage interest, as well as capital gains exemptions on the sale of an individual's primary residence

– Phasing in a federal consumption and/or carbon tax

– Means-testing receipt of Social Security benefits

While these may be constructive alternatives from a debt reduction standpoint, all are political non-starters in the current environment, and any changes would fundamentally shift drivers of the US economy, savings, and investment patterns over the long term.

6 https://www.pewresearch.org/short-reads/2023/09/13/congress-has-long-struggled-to-pass-spending-bills-on-time
7 https://www.pewresearch.org/short-reads/2023/09/13/congress-has-long-struggled-to-pass-spending-bills-on-time

Lessons from the 1990s

While the gap between the IMF's proposal and what's politically practical in the near term is immense, the US did achieve a balanced budget during the 1990s and we can look at that experience for two key lessons: focus on tax reform and eschew political consequences. For example, broad simplification of the tax code was achieved in 1986 and passed by majorities of both parties in both houses of Congress. Later, a political price was paid by many for support of higher taxes in the 1993 budget, however it was a combination of higher revenues and an improving economy that produced, by 1998, the first federal budget surplus since 1969.[8]

We're ending the first Presidential election cycle in recent memory that hasn't occurred in a period of either long term interest rate decline, or the zero interest rate period of the post global financial crisis (GFC) era. Debts, deficits, and borrowing costs will increase in the future. Both parties, regardless of the election outcome, must take steps toward fiscal adjustment in this window of opportunity.

8 https://www.sciencedirect.com/science/article/abs/pii/S0362331902002586

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