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WASHINGTON POLICY STRATEGY

Potomac Perspective

A second Trump administration will promote a pro-growth and deregulatory agenda even as some policies deviate from a traditional Republican approach – it is a mix of populism and free market economics. Parts of this ambitious agenda can be implemented administratively while other parts, like tax cuts, must be passed by Congress. Investors have already seen how complicated that can be.

In our 2025 Outlook, we discuss which parts of his agenda Mr. Trump will pursue first, which parts could take longer to enact, and how some of his campaign promises will probably be changed as they go through the political process. After discussing Mr. Trump's economic policy priorities, we analyze what his agenda could mean for a group or sector.

President-elect Donald Trump and congressional Republicans have an ambitious policy agenda planned for 2025. In our 2025 Outlook, we preview which parts of the economic policy agenda can be implemented easily, which parts will take more time, and we discuss possible implications for investors.

The overall policy themes for 2025 will generally be less government and deregulation, but there will be exceptions. Tax policy will be a primary focus since parts of the Tax Cuts and Jobs Act of 2017 (TCJA) expire after 2025. Extending the sunsetting provisions and cutting additional taxes will be a top priority for the incoming administration as will be efforts to cut government spending. The regulatory agencies, which Mr. Trump will now lead, are likely govern with a lighter touch. Still, the incoming administration will deviate from Republican orthodoxy as it will pursue tariffs on imports which runs counter to the historic Republican position on free trade and it will differ on antitrust policy from the hands-off approach that has been the Republican view for the past 50 years. The base of the Republican Party has become more working class than it has been, and policies will reflect that. The Trump administration is likely to be friendlier to labor and less deferential to capital than what we typically see from Republican governments.

Extending the TCJA

The sunsetting provisions of the TCJA include:

- Lower individual income tax rates
- Relief from the Alternative Minimum Tax
- The $10,000 cap on the State and Local Tax (SALT) deduction
- Higher exemption from the estate tax
- Sec. 199A qualified business income deduction (for pass-throughs).

Republicans will try to extend the sunsetting provisions, but they will face several hurdles. In addition to extending the expiring tax cuts, during the 2024 campaign, Mr. Trump proposed making income from tips, overtime pay, and Social Security benefits exempt from federal income taxes.

Congressional Republicans will use a legislative process known as "budget reconciliation." This is usually used to overcome a Senate filibuster and pass the bill with a simple majority vote rather than the usual 60-vote requirement. The Senate, however, might not be the GOP's biggest problem. In the House, Republicans hold a thin 220-215 majority. Due to three vacancies, they will only have 217 members in early 2025, which means they will not be able to afford a single defection in the House for the first few months of the year. When the TCJA passed in 2017, House Republicans had 239 House Republicans, and 12 Republicans voted against the final bill. There is no such room for error this time.

The main reason for the Republican defections in 2017 was disagreement over the cap on the SALT deduction. Republicans from high tax states want relief from the SALT. Restoring full SALT deductibility would add approximately $1.2 trillion to the national deficit over 10 years according to the Center for a Responsible Federal Budget. Budget hawks will be concerned about the overall price tag. According to the Congressional Budget Office, extending all the sunsets for 10 years would add approximately $4.6 trillion to the national debt. This projection does not include the Trump promises not to tax tips, overtime pay, and Social Security benefits, nor raising the SALT cap.

Some Republican leaders are comfortable with extending the expiring TCJA provisions without offsets on the grounds that extending existing policy does not need to be "paid for," but any new policy, such as raising the SALT cap or exempting tip income from taxes, will likely meet some resistance.

To cap the cost of extending the TJCA, Congress might consider eliminating some Inflation Reduction Act (IRA) tax credits. Even though these credits seem to be an easy "pay-for," IRA tax credits are being used to finance clean-energy construction projects in Republican states and districts. Lawmakers representing these areas might be reluctant to eliminate tax credits which support jobs for their constituents.

It is likely Congress will extend most of the TCJA's sunsetting provisions, but competing policy priorities and razor thin majorities, especially in the House, will mean that the final form of a tax bill will be the product of negotiations which could take several months.

Tariff Agenda

Throughout the campaign, Mr. Trump repeatedly promised to increase tariffs on goods imported into the United States. Whereas Mr. Trump will need Congress's approval on a tax bill, he can act unilaterally on many tariffs. His campaign did not give details about how the tariffs would work, what goods would be subject to these tariffs, or what laws he would use to implement them, but here are some broad outlines that investors should consider for the coming year:

China

Mr. Trump said he would impose a 60% tariff on Chinese imports. We assume he meant that he would increase the current 25% tariff up to 60%. Furthermore, he recently threatened a 10% tariff on Chinese imports, which we view as the first tranche of additional tariffs that would eventually lead to the 60% target. Mr. Trump has not said whether the list of products subject to the tariffs would be changed. The Office of the United States Trade Representative (USTR) is likely to start the process to increase tariffs on China in early 2025 with actual implementation likely in mid-or-late 2025.

China retaliated against the 2018 American tariffs and has threatened additional responses if the U.S. increases the current tariff levels. After the U.S. imposed tariffs in 2018, China imposed a 2% tariff on $50 billion worth of American goods. It has also diversified its agricultural imports, so it relies less heavily on America imports. More recently, China has banned the export of rare elements such as gallium, germanium, and antimony and imposed export control restrictions on several American companies. The latter might be mostly symbolic, lest tougher restrictions hurt the Chinese economy, but these actions signal that China will retaliate against additional U.S. levies. In addition to additional tariffs, China could also respond by further weakening its currency and by launching investigations into American companies that do business in China.

Global

Mr. Trump has proposed a 10% to 20% baseline tariff on all imports. It is unclear what trade law he would use to implement this proposal, and while some might consider this factor to be unimportant, choosing among different trade laws has consequences. Section 122 of the Trade Act of 1974 gives a president the ability to impose an additional 15% tariff in cases where there is a "persistent" balance of payments deficit. This authority only lasts for 150 days, however, and must be reauthorized by Congress. Mr. Trump might declare a national emergency and use the powers granted to him under the International Emergency Economic Powers Act, but the authority under this law has been used for specific countries and not on a worldwide basis. Courts typically defer to presidents when they declare national emergencies, but it is unclear whether the courts would allow a president to declare a national emergency with respect to the entire world or large parts of it.

North America

President-elect Trump has also proposed tariffs on imports from Canada and Mexico. Some of the tariffs he has in mind might violate the United States-Mexico-Canada Agreement (USCMA) he negotiated in his first term, but this proposal might be an opening bid in the 2026 review of the USMCA. That review is still over a year away and a lot can change between now and then, but it appears the Trump administration is going to push for new "country of origin" rules on Mexico to prevent China from using it as an end-around American tariffs and restrictions on China. It is also possible Mr. Trump could withdraw the U.S. from the agreement and seek a bilateral trade deal with Canada, which could be disruptive to Latin American trade.

Budget/DOGE

The incoming Trump administration has created a Department of Government Efficiency (DOGE), which is an advisory committee run by Elon Musk and Vivek Ramaswamy. DOGE has no real authority other than to make recommendations. For example, we think DOGE could recommend that Congress eliminate agencies such as the Department of Education or the Consumer Financial Protection Bureau. Regardless of what one thinks of these organizations, the chances Congress will eliminate them are extraordinarily low, especially given Republicans' narrow majorities in the House and Senate. Simply put, there are not enough votes in Congress to eliminate federal agencies.

Congress might try to reduce spending but, again, given the narrow Republican majorities and the fact that there are programs for which DOGE might recommend reducing spending, but which have Republican supporters, it will be difficult to make meaningful budget cuts. Even Treasury Secretary nominee Scott Bessent's goal of reducing federal budget deficits to 3% of GDP is ambitious.

Entitlement programs and interest payments on the debt make up 70% of federal spending, and Mr. Trump will not consider changes to Social Security and Medicare. Of the remaining 30% of the budget, roughly 15% (1/2 of discretionary spending) is spent on defense, for which the Trump administration will seek large increases. Republicans will look to the remaining 15% of the budget for savings, especially from Medicaid, but we doubt Congress will cut too deeply into programs that are mostly popular.

We expect DOGE will achieve some symbolic budget savings, but we are skeptical that it will have a material impact on the trajectory of federal spending. Deficits are likely to increase, albeit at a lower rate of growth.

Immigration

A centerpiece of the Trump campaign was a promise to implement mass deportations of illegal immigrants. Such a policy could have negative implications for industries that rely on low-skill, undocumented workers. It is also likely a logistical and operational nightmare. While we do not dismiss the possibility that the Trump administration could pursue across-the-board deportations of illegal immigrants, we expect it will initially target illegal immigrants who have criminal backgrounds either in the U.S. or in their home countries. A rolling implementation of a policy that targets immigrants with criminal backgrounds first and addresses other illegal immigrants later could delay the economic impact of deportations.

A successful implementation of the Trump immigration policy could eventually lead to broader immigration legislation, which could include an increase in the number of visas for high skilled workers. This is probably unachievable without addressing the illegal immigrant situation first, but it could open the door to increased legal immigration. The recent debate that exploded on social media following Elon Musk's and Vivek Ramaswamy's proposal to increase the number of H-1B visas underscored how politically difficult it will be to address legal immigration until illegal immigration is addressed first.

Antitrust Policy

The differences between the two parties regarding antitrust policy has been narrowing in recent years, so we do not expect as big of a shift in policy when the Trump administration takes over. M&A activity could increase as the Trump administration might be less aggressive in challenging mergers, but we do not expect a 180-degree shift in policy. President-elect Trump has nominated Gail Slater to lead the Department of Justice's Antitrust Division and Andrew Ferguson to succeed Lina Kahn as the Chair of the Federal trade Commission (FTC). Mr. Trump has also nominated Mark Meador to serve on the FTC. We view Slater and Ferguson as more pragmatic and less ideological than their predecessors, but neither appointment represents a turn to a laissez-faire approach to antitrust policy.

Sector Comments

Energy – Although some key parts of the Mr. Trump's energy agenda will need congressional approval, which could be slow in coming, the president-elect will have some flexibility in opening federal lands to exploration and production and in ending the liquefied natural gas export moratorium. Although Trump is not a clean energy supporter and opposes subsidies for the industry, his administration could speed up permit applications. Broader permitting reform has stalled in Congress in the past, but the issue is likely to reemerge in 2025. We see some possibility for a bipartisan deal, although we acknowledge that legislation could meet a similar fate as past efforts. The administration will likely propose ending the electric vehicle mandate, but Republicans might have a tough time including such a proposal in a reconciliation bill because it is not primary a budget issue. Eliminating the mandate under regular order (i.e., 60 votes in the Senate) would be highly unlikely. As we mentioned above, the administration might also try to eliminate the IRA clean anergy tax credits, but these credits might prove to be more popular among Republicans in whose states and districts construction projects will be financed by the credits. Republicans might cap the value of the IRA tax credits as an alternative to completely eliminating them.

Financials – Financials could be one of the biggest sector beneficiaries once Mr. Trump takes office. Much of the Trump economic policy team (except for some nominees in the antitrust sphere) are standard Republican nominees. Although new banking regulators have yet to be named, the nominations of Scott Bessent for Treasury, Kevin Hassett for the National Economic Council, and Paul Atkins for the Securities and Exchange Commission all point to a deregulatory policy for financials. Once in place, we expect banking regulators will make the bank merger application process more efficient, especially for mid-sized and smaller banks. The largest regional banks will probably still endure a lengthy process for any mergers they might propose, but we expect a quicker process for these banks as well. Congress will likely debate cryptocurrency legislation, and, while the odds of passing crypto-related bills is far from a slam dunk, there could be meaningful progress on stablecoin legislation in 2025. Regardless of what Congress does on digital assets, the regulatory environment is likely to be much more benign than over the past four years. Regarding mortgage finance, although Mr. Trump has not yet named a Director for the Federal Housing Finance Agency, we think the conditions are in place to release Fannie Mae and Freddie Mac from conservatorship. This does not appear to be a top priority for the Trump administration, so we doubt the two government sponsored enterprises (GSEs) will be privatized in 2025, but there could be additional steps that lead to a recap and release of the GSEs down the road.

Technology – Above we mentioned that the incoming administration will probably not significantly deviate from the Biden administration on antitrust policy. This is especially true for the technology sector. The sector is already subject to several investigations and enforcement actions, and we expect those will continue. In fact, FTC Commissioner Ferguson vowed to "end Big Tech's vendetta against competition and free speech." Also, FTC nominee Meador has drafted legislation that would target Google's ad business and has suggested using discriminatory pricing laws that remain on the books but have not been used in recent history. Ms. Slater has worked at the FTC and on the Senate staff of Vice President-elect JD Vance, who has been an outspoken critic of Big Tech. We expect she will reflect the views of Mr. Vance when she is confirmed for the DOJ position.

Defense – Mr. Trump campaigned on significant increases in the defense budget, but the Republicans' narrow majority in the House and fiscal realities probably limit what Congress will approve. House Freedom Caucus Republicans are budget hawks who have voted against recent defense budgets and are likely to do so again. While some Democrats will support modest increases in defense spending, they are unlikely to support the amounts that the Trump administration proposes. These negotiations will be especially difficult, as the DOGE has said it wants to cut $2 trillion from the budget (mostly from non-defense programs) at the same time that Republicans are trying to pass a large tax cut.