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2024 U.S. Elections: Four Key Issues for Markets and the Economy

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Key Insights

- The future path of fiscal policy is subject to uncertainty around the sunset of several provisions of the Tax Cuts and Jobs Act at the end of 2025, the trajectory of interest rates, and spending on entitlement programs like Medicare and Social Security. Our view is that this will result in higher interest rate volatility than the decade following the Great Financial Crisis.
- The next President will appoint a new Fed Chair in 2026, and the Fed's current 2% inflation target could be the subject of intense scrutiny. A higher inflation target would likely lead to higher long-term yields.
- Given the positive boost from immigration to the labor market and general economic growth in 2023, the short-term impact of a more restrictive stance on unauthorized migrants should not be ignored. However, the long-term impact would be less significant relative to current projections.
- The imposition of large and broad tariffs on China and other trade partners could be the most consequential to short-term market performance.
- We see both risks and opportunities stemming from the November election, and we will continue studying their evolution over the next few months. We recommend investors stay the course and remain anchored in their long-term investment strategies.

With about three months remaining until the Democratic and Republican National Conventions, the candidates that will represent the two parties in the 2024 U.S. Presidential election are known. Incumbent President Biden (D) will run against former President Trump (R), while independent candidate Robert F. Kennedy Jr. is polling higher (into the double digits in some polls) than any third-party candidate since 1992 when Ross Perot took close to 19% of the popular vote. It is too early for financial markets to be significantly influenced by assumptions on potential outcomes of the November election. However, the de-facto conclusion of the primaries has narrowed the range of possible scenarios and allows us to focus on what we think will be four defining issues for voters and investors: fiscal policy, monetary policy, immigration policy, and trade policy.

Fiscal policy

Most provisions of the 2017 Tax Cuts and Jobs Act (TCJA) impacting individuals will expire at the end of 2025, and how policy makers address this will depend on the outcomes of the House, Senate, and presidential elections. A Republican administration, especially if supported by a Republican Congress, would be more inclined to extend many TCJA provisions, while President Biden has publicly stated the need to raise taxes on wealthy taxpayers (individuals making more than $400,000) and would likely oversee a significant overhaul of the expiring tax cuts.

In a divided government scenario, a more moderate and bipartisan approach would be necessary to avoid a situation where many of these provisions expire, resulting in tax increases for many Americans.

Given the already sizeable fiscal deficit, the legacy of both the TCJA and post-Covid spending trends, it is worth focusing on how an extension of current tax cuts would impact the trajectory of U.S. public debt. The Congressional Budget Office (CBO) projects the debt-to-GDP ratio to rise to 116% in 2034, up from 97% at the end of 2023. However, these assumptions could change meaningfully based on how policymakers handle the TCJA sunset. Using the CBO's projections of what the annual cost of each expiring provision would be during the next 10 years, *we estimate that, in a scenario in which all expiring tax cuts are extended, publicly owned U.S. government debt could be about $4.6 trillion higher at the end of 2034.*

The continuation of the recent fiscal stimulus may result in bond investors demanding a higher premium, also known as term premium[1], to own longer-dated government debt. If interest rates found a new equilibrium around current levels to appropriately price the new inflation, monetary and fiscal dynamics, this would add further upside pressure to the CBO's baseline projection of the debt-to-GDP ratio.

We estimate that, if current market yields stayed (on average) at current levels over the next decade, the average interest rate paid by the U.S. Treasury would be 4.3% by the end of 2034 — much higher than the 3.4% assumption embedded in the CBO's baseline projections. This would result in an additional $2.8 trillion added to the U.S. debt by the end of 2034.[2]

At the same time, continued fiscal stimulus could reasonably raise nominal GDP growth above current CBO projections, therefore partially offsetting the hit from lower tax revenues and higher interest rates. However, it is worth pointing out that the economy looks much different today than it did when the TCJA was first passed in 2017, reducing the multiplier effect of a large fiscal deficit (Figure 1). That said, a looser fiscal stance could put upward pressure on inflation and raise nominal economic growth. *We estimate that the U.S. economy would be $4.5 trillion larger in 2034 if nominal GDP growth averaged 5% instead of the 4% projected by the CBO.*

Different combinations of all the assumptions and their variations as described above would result in a wide range of possible outcomes. However, even the most benign scenario could yield significantly higher debt levels by the end of the 10-year projection period. *Our view is that this will keep interest rate volatility more elevated than the decade following the Great Financial Crisis (2007-2009), which will require a more careful construction and management of fixed income portfolios.*

Figure 1 - Side-to-side comparison of key economic and market data (Today vs. December 2016)

	Today	December 2016
Nominal GDP Growth (YoY)	5.9%	3.5%
Headline CPI (YoY)	3.5%	2.1%
Unemployment Rate	3.8%	4.7%
U.S. Budget as % GDP	-5.9%	-3.1%
Personal Income Growth (YoY)	4.6%	3.3%
Personal Savings Rate (YoY)	3.6%	5.0%
S&P500 P/E Ratio	24.03	20.56
S&P500 Profit Margin	10.7%	8.4%

Source: Bloomberg Finance, TIAA Wealth Chief Investment Office

[1] The term premium is defined as the compensation that investors require for bearing the risk that interest rates may change over the life of the bond. Since the term premium is not directly observable, it must be estimated, most often from financial and macroeconomic variables (source: Federal Reserve).
[2] Assuming the current maturity distribution of Treasury debt remains constant, and that maturing debt is refinanced at current yields.

Monetary policy

The next President will appoint a new Fed Chair once Jerome Powell's term ends in May 2026, and the next Senate will have to approve the nomination. This process will be closely followed by market participants, given that the Fed's independence is crucial to its credibility in managing the dual mandate of stable prices and maximum employment.

As discussed above, inflation can work as an offsetting factor for a higher debt burden, slowing the pace of increase in the debt-to-GDP ratio. *This is a reason why future administrations may be more likely to accept slightly higher levels of inflation.*

Therefore, we believe that, regardless of the outcome of the 2024 election, the debate around whether the current rigid 2% inflation target should be raised or replaced with a more flexible inflation target range may gain popularity in DC. Similar to the acceptance of higher structural levels of fiscal deficit described earlier, signaling a higher tolerance to inflation would likely result in a steeper yield curve, a higher term-premium, and more elevated interest rate volatility.

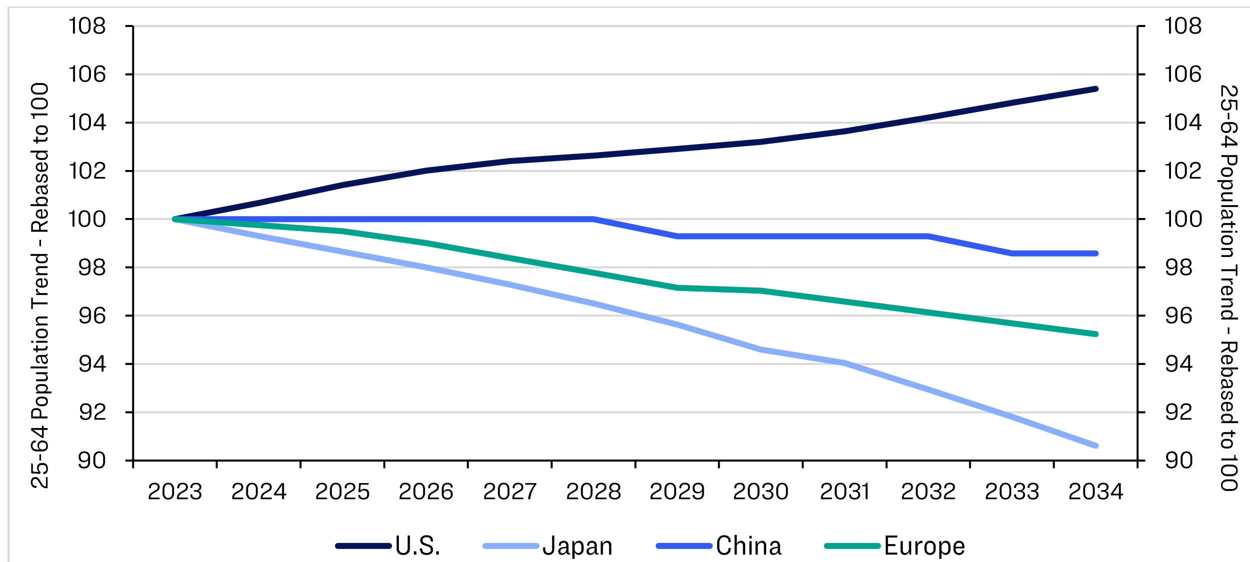
Immigration policy

The CBO estimates that the foreign-born U.S. population grew by 2.7 million and 3.3 million in 2022 and 2023, respectively, and projects a net immigration flow of 7.7 million between 2024 and 2026, before the pace is expected to normalize starting in 2027. These estimates bode well for the growth potential of the U.S. economy. But they also hinge on the administration that will shape immigration policies during the next presidential term. The portion of the CBO projections likely to be most sensitive is the estimate of unauthorized residents, accounting for roughly two-thirds of the total expected increase in the foreign-born population over the next three years.

During President Trump's first term, the unauthorized foreign population was unchanged, according to CBO data. Based on this historical precedent and a more adverse stance on immigration, if the net change in unauthorized residents fell to zero, *we estimate that the labor force could be approximately 600,000 people smaller than what is projected in 2026 by the CBO, assuming labor force participation rates remain constant.* Longer term, the impact would be less relevant since the CBO projects entry of unauthorized residents to drop to an average of 200,000 per year after 2026.

While we think different approaches to immigration might determine to what extent the recent labor supply boost can continue to exert downward pressure on inflation over the next few years, changes in unauthorized migration flows relative to the CBO's baseline projection would not be material enough to significantly impact GDP growth potential, provided other categories of immigration do not deviate materially from the projections. This should allow the United States to maintain an economic growth edge over other developed economies where the labor force is projected to shrink over the next 10 years. (Figure 2).

Figure 2 – Population trend of those aged 25-64 (indexed to 100)



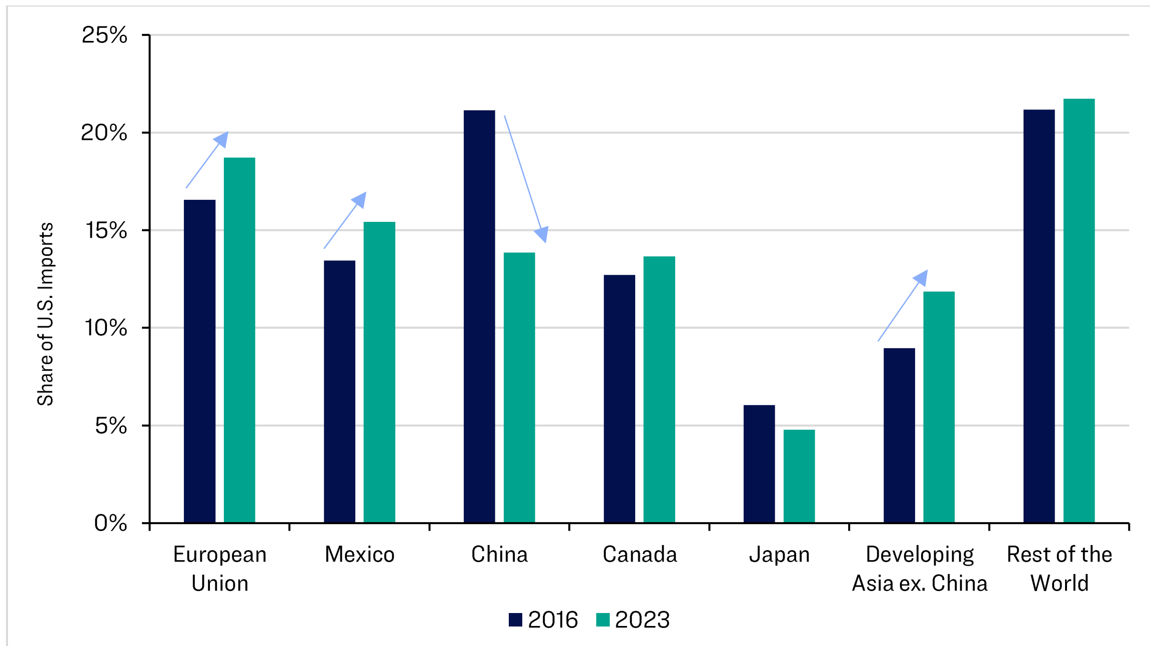
Source: Congressional Budget Office, European Commission, Japanese National Institute of Population and Social Security Research, World Bank, TIAA Wealth Chief Investment Office

Trade policy

During his first term and under the authority granted by Sections 232 and 301 of the Trade Expansion Act of 1962, President Trump imposed a 25% levy on imported steel and a 10% levy on imported aluminum, and an average 19.3% tariff on $362 billion worth of imports from China. Notably, the Biden administration retained most of the tariffs imposed by the Trump administration as it undertakes a review of those actions, highlighting the protectionist stance that now crosses party lines. More recently, the Biden administration imposed new restrictions in late 2023 that will limit China's access to advanced computing and artificial intelligence technology and related equipment from the United States, and just announced further levies on $18 billion in Chinese imports including a quadrupling of tariffs on electric vehicles from 25% to 100%.

The focus on China has caused key parts of global supply chains to be redirected through other emerging markets in Southeast Asia and Latin America, a trend that was accelerated by the Covid-19 pandemic. The result has been an increase in total world exports of 45% since 2016, led by a 60% increase in exports from emerging and developing countries. Mexico has seen its share of total U.S. imports increase from around 12.5% in 2016 to 15% today, while U.S. imports from Asian countries other than China have jumped considerably to levels roughly the same as imports from Mainland China. Several emerging economies have seen their balance of payments improve as a result, allowing their central banks to be more aggressive in tackling rising inflation that began in 2021 without causing significant currency and capital market volatility (Figure 3).

Figure 3 – Share of U.S. imports, 2016 vs 2023



Source: Census Bureau, International Monetary Fund, TIAA Wealth Chief Investment Office

A strategy of protectionism and decoupling from China seems to be widely shared by both parties in Congress. However, meaningful differences exist in how this posture is likely to be implemented by the two parties. In particular, one of the key campaign promises of President Trump is to impose a blanket 10% tariff on all U.S. imports and a 60% tariff on all Chinese goods. Given the comprehensive nature of these levies and the likelihood of reciprocal measures from trade partners, the hit to global trade flows and hence global growth, could be material given that the U.S. accounts for around 10% of total trade flows globally. Those emerging economies that have been able to take advantage of China's diminished role as a trade partner to the U.S. could see some of that progress wane.

Domestically, the broad implementation of tariffs could result in a mix of U.S. dollar appreciation, lower corporate profit margins if businesses absorb higher input costs, and higher consumer inflation if businesses instead decide to pass higher costs on to end-users. From an inflation standpoint, it is worth noting that the impact of tariffs on both CPI and PCE inflation following the imposition of tariffs in 2018 was minimal, given that Chinese imports account for less than 2% of the PCE basket. The imposition of tariffs on all imported goods could be more consequential on inflation, given that the import content in total PCE is around 10% (SF Fed).[3]

There remains significant uncertainty around how much these campaign promises might translate into concrete actions. However, even a partial implementation of these measures would likely inject volatility in global financial markets. A stronger dollar would weigh on countries with large external accounts and high levels of dollar-denominated debt, and on companies with a sizeable share of revenues produced abroad. And higher input costs could be a headwind for domestic stocks by reducing profit margins or dampening consumer demand.

[3] How Much Do We Spend on Imports? - San Francisco Fed (frbsf.org)

Therefore, our view is that the evolution of this issue on the campaign trail and during the first year of the new administration could be the most consequential to short-term market performance.

Final Thoughts

We see both risks and opportunities stemming from the November election, and we will continue studying their evolution over the next few months. As highlighted in previous research, while markets might experience some volatility before and after the vote, this tends to wash out as the focus shifts back to fundamentals like economic growth, inflation, productivity, the labor market, and corporate earnings. Therefore, we recommend investors stay the course and remain anchored in their long-term investment strategies.

To learn more about how the 2024 U.S. Presidential election might impact your financial plan, talk to your TIAA Wealth Management advisor today.

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