Special Commentary — March 7, 2024

# The 2024 U.S. Elections Compendium


## Summary

The 2024 U.S. election cycle has arrived, and with it have come questions about what the election will mean for the economic outlook. This compendium compiles a recent three-part series we wrote that examines the election and its economic implications from multiple angles. In Part I, we provide some background on this year's election including the outlook for control of the House of Representatives, Senate and White House. In Part II, we reviewed what history tells us about Federal Reserve monetary policy decisions in election years and discussed how election outcomes impact the FOMC. Finally, in Part III we explored the post-election fiscal policy outlook. Specifically, we examined the timeline for the next debt ceiling showdown, the outlook for the annual budget process, the longer-run fiscal outlook and the economic implications of the looming expiration of large parts of the Tax Cuts and Jobs Act.



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The 2024 U.S. Elections

# Part I: Setting the Stage

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## Summary

- The 2024 U.S. elections will be a defining feature of the year as households, businesses and investors weigh the election's economic implications. So far, the presidential nomination process for the two parties has been relatively uneventful. A 2024 election rematch of Joe Biden and Donald Trump seems highly probable. If this occurs, it would become just the third instance in U.S. history of a race between two or more individuals who had been president previously.
- With roughly nine months to go until Election Day, much can change between now and then. That said, if the 2020 election is indicative of the 2024 rematch, the race should be fairly competitive. Biden carried the day in 2020, winning the Electoral College 306-232 and the popular vote 51.3%-46.9%. But, several key swing states were decided by very tight margins.
- We will be keeping an eye on head-to-head polls, approval ratings, prediction markets, forecasts of top political analysts and, of course, economic conditions to monitor the race. President Biden's net approval rating is currently a bit weaker than Donald Trump's was at this point in his first term. At present, prediction markets appear to give the edge in the race to Donald Trump, albeit not overwhelmingly so as neither candidate's odds are above 50%. Political forecasters, such as Larry Sabato and team at the University of Virginia's Center for Politics, also do not seem to see a clear-cut favorite at this point in time.
- The race for the White House may gain the most attention, but control of Congress will also play a critical role in shaping the economic policy outlook. In recent years, unified party control of the House of Representatives, Senate and White House has produced much of the major legislation that has driven shifts in the economic outlook.
- At present, Republicans hold a slim majority of 219-213 in the House of Representatives, with three seats currently vacant. All 435 seats in the House are up for election every two years, and it takes 218 seats to hold the majority.
- Big swings in the makeup of the House tend to occur in midterm elections rather than in presidential elections. Majority control of the House has not switched parties in a presidential election year since 1952. At the moment, Republicans have a small edge in the generic ballot polling. That said, given that Republicans have such a small majority, Democrats need to pick up just a handful seats on net to retake the House, so a change in majority control would not surprise us.
- The outlook for control of the Senate is more unique compared to the House. The Senate is currently split between 49 Republicans, 48 Democrats and 3 Independents who caucus with the Democrats, thus giving the Democrats a small majority.
- Political analysts generally view this year's Senate map as more favorable to Republicans. There are 34 Senate seats up for grabs: 23 are held by Democrats (including the three independents) and 11 are held by Republicans. As a result, Democrats are playing “defense” in more states than Republicans.
- Furthermore, Democrats are defending three seats in states that Donald Trump won in 2020 (West Virginia, Montana and Ohio) as well as several more in states that were competitive at the presidential level in 2020. These factors afford Republicans more opportunities to capture the much-coveted 51st seat, although there remains a long road ahead to Election Day.

## Welcome to the 2024 Election Cycle

The 2024 election cycle has arrived, and with it attention has turned to what the elections mean for the economic outlook. In a recent report, we examined the relationship between election years and various economic variables such as real GDP growth, employment and consumer spending. In this report, which is Part I in a series on the U.S. presidential election and its implications for the U.S. economy, we provide some background on this year's election. In Part II, we will review what history tells us about Federal Reserve monetary policy decisions in election years. In Part III, we will examine some key economic policy areas that will be impacted by this year's election outcome.

## Control for the White House: An Unusual Rematch

In a presidential election cycle, attention naturally gravitates to the race for the White House. Yet, so far the nomination process for the two parties has been relatively uneventful. On the Republican side, former President Donald Trump appears to be firmly in control of the nomination for his party. Initial wins in the Iowa caucuses and New Hampshire primary as well as a robust lead in the polls suggest it would take a major development to derail his road to the nomination. Similarly, current President Joe Biden seems unlikely to be unseated by his main challenger, House of Representatives member Dean Phillips.

***A 2024 election rematch of Joe Biden and Donald Trump seems highly probable. If this occurs, it would become just the third instance in U.S. history of a race between two or more individuals who had been president previously.***

Thus, a 2024 election rematch of Joe Biden and Donald Trump seems highly probable. If this occurs, it would become just the third instance in U.S. history of a race between two or more individuals who had been president previously. In 1912, incumbent President William Taft, a Republican, faced a challenge from the Democratic Governor of New Jersey Woodrow Wilson. However, Theodore Roosevelt, who was president from 1901-1909 as a Republican, ran as a third party candidate as part of the Progressive or "Bull Moose" party. The other instance occurred in 1888 and is more analogous to today's situation. The 1892 election was a rematch of the 1888 election and featured incumbent Republican President Benjamin Harrison against former Democratic President Grover Cleveland. In that campaign, the sitting incumbent (Harrison) lost, and Grover Cleveland became the first and only person in American history to be elected to a non-consecutive second term. If Donald Trump wins the presidency this November, he would be the second person to accomplish this feat.

Part I: Figure 1

**U.S. Presidential Election Results: Key States**

| | Electoral Votes | | Popular vote: Republican - Democrat (%) | | |
|---|---|---|---|---|---|
| State | Trump | Biden | 2020 Trump-Biden | 2016 Trump-Clinton | 2012 Romney-Obama |
| Colorado | 0 | 9 | -13.5 | -4.9 | -5.4 |
| New Mexico | 0 | 5 | -10.8 | -8.2 | -10.1 |
| Virginia | 0 | 13 | -10.1 | -5.3 | -3.9 |
| Maine | 1 | 3 | -9.1 | -3.0 | -15.3 |
| New Hampshire | 0 | 4 | -7.4 | -0.4 | -5.6 |
| Minnesota | 0 | 10 | -7.1 | -1.5 | -7.7 |
| Michigan | 0 | 16 | -2.8 | 0.2 | -9.5 |
| Nevada | 0 | 6 | -2.4 | -2.4 | -6.7 |
| Pennsylvania | 0 | 20 | -1.2 | 0.7 | -5.4 |
| Wisconsin | 0 | 10 | -0.6 | 0.8 | -6.9 |
| Arizona | 0 | 11 | -0.3 | 3.5 | 9.1 |
| Georgia | 0 | 16 | -0.2 | 5.1 | 7.8 |
| North Carolina | 15 | 0 | 1.3 | 3.7 | 2.0 |
| Florida | 29 | 0 | 3.4 | 1.2 | -0.9 |
| Texas | 38 | 0 | 5.6 | 9.0 | 15.8 |
| Ohio | 18 | 0 | 8.0 | 8.1 | -3.0 |
| Iowa | 6 | 0 | 8.2 | 9.4 | -5.8 |
| **Total** | **232** | **306** | | | |

Source: Federal Election Commission and Wells Fargo Economics

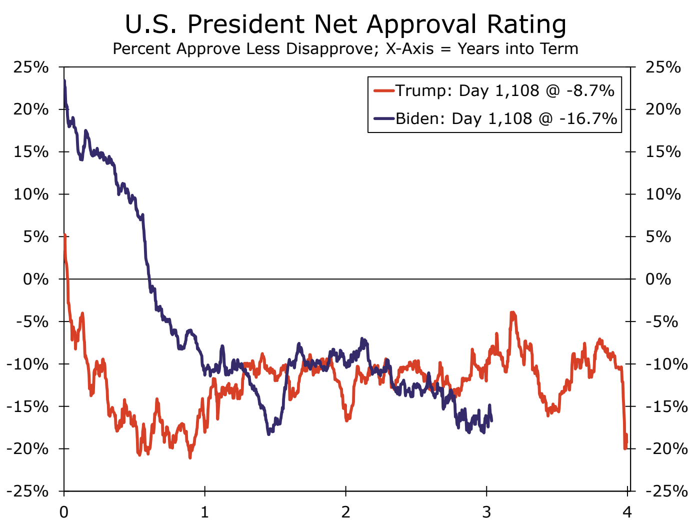
***The U.S. economy appears poised to achieve a "soft landing", but recession risks remain elevated in our view.***

With roughly nine months to go until Election Day, much can change between now and then. Look no further than the last presidential election, when a global pandemic rocked the world and upended that year's race. Today, the U.S. economy appears poised to achieve a "soft landing" as economic growth remains resilient and inflation slows, but recession risks remain elevated in our view. That said, if the 2020 election featuring Joe Biden and Donald Trump is indicative of the 2024 rematch, the race should be fairly competitive. Biden carried the day in 2020, winning the Electoral College 306-232 and the popular vote 51.3%-46.9%. But, several key swing states including Georgia, Arizona and Pennsylvania were decided by tight margins (Figure 1).

Both President Biden and President Trump possessed net approval ratings that were "underwater" at this point in their presidencies (Figure 2). However, President Biden's net approval rating is currently a bit weaker than Donald Trump's was at this point in his first term. At present, prediction markets seem to view Donald Trump as the favorite to win the presidency, albeit not overwhelmingly so. The RealClearPolitics aggregator for various prediction and betting markets assigns a greater probability to a Trump presidency than a Biden one, but neither candidate's odds are above 50% (Figure 3). Political forecasters, such as Larry Sabato and team at the University of Virginia's Center for Politics, do not seem to see a clear cut favorite at this point in time. Sabato's Crystal Ball projections currently have 260 electoral college votes in the Democratic column and 235 in the Republican column, with the remaining 43 electoral college votes in the "toss-up" category.[1] On balance, there remains plenty of uncertainty about who will emerge victorious on election night in November.

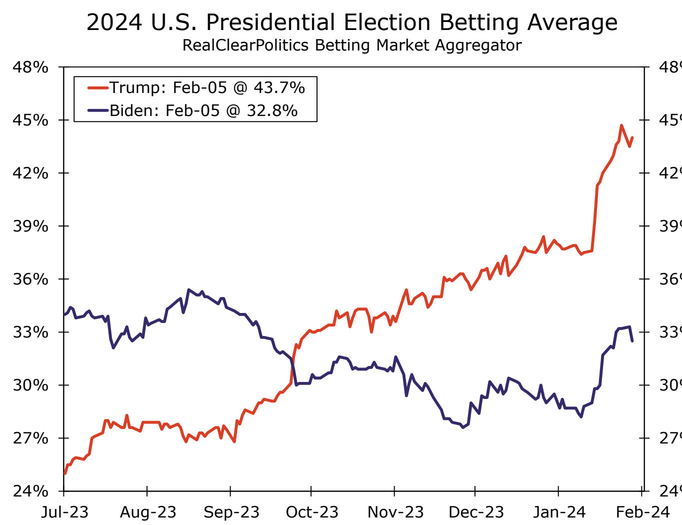
***Both President Biden and President Trump possessed net approval ratings that were "underwater" at this point in their presidencies.***

Part I: Figure 2




Source: 538 and Wells Fargo Economics

Part I: Figure 3




Source: Bloomberg Finance L.P. and Wells Fargo Economics

## Control of the House: A Tight Race

The race for the White House may gain the most media attention, but party control of Congress also will play a critical role in shaping the economic policy outlook for 2025 and beyond. Periods of unified party control of the House of Representatives, Senate and White House have generated much of the major legislation that has become law in recent years. The Inflation Reduction Act under President Biden, the Tax Cuts and Jobs Act under President Trump and Dodd-Frank and the Affordable Care Act under President Obama were all enacted during periods of unified control of Congress and the White House. In contrast, divided control of Congress and the White House has frequently led to gridlock or more incremental policy changes.

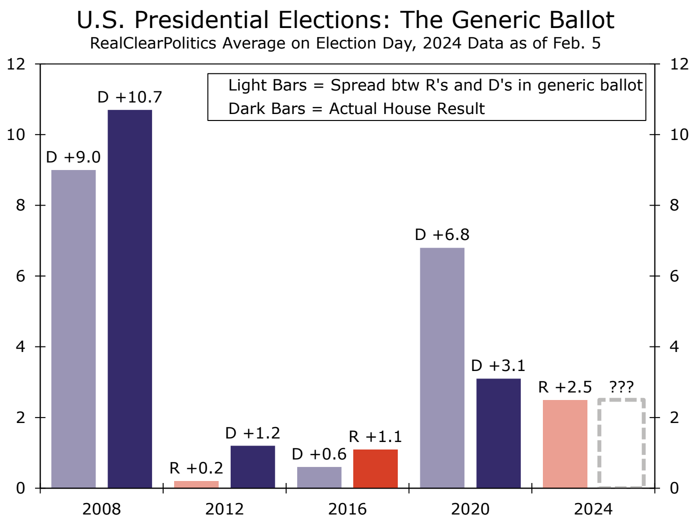
***Periods of unified party control of the House of Representatives, Senate and White House have generated much of the major legislation that has become law in recent years.***

At present, Republicans hold a slim majority of 219-213 in the House of Representatives, with three seats currently vacant. All 435 seats in the House are up for election every two years, and it takes 218 seats to hold the majority. Generally speaking, big swings in the makeup of the House of Representatives occur in midterm elections rather than in presidential elections. The average net change in House seats over the past seven presidential elections is eight seats, much smaller than the average net change of 24 seats in midterm elections over the same period. Furthermore, majority control of the House of Representatives has not switched parties in a presidential election year since 1952.

That said, given that Republicans have such a small majority, Democrats need to pick up just a handful seats on net to retake the House, so a change in majority control would not surprise us. One tool utilized by political analysts to measure the general state of the race for control of the House is generic ballot polling. Generic ballot polling asks respondents whether they would vote for a Republican or Democrat for Congress without actually naming specific candidates. Figure 4 shows the RealClearPolitics generic ballot polling average as of February 5, as well as the average position of this indicator on Election Day in the past four presidential cycles.

***Majority control of the House of Representatives has not switched parties in a presidential election year since 1952.***

Part I: Figure 4




Source: RealClearPolitics and Wells Fargo Economics

As can be seen, the generic ballot polling average has come within a few percentage points of the actual House popular vote margin in the past few presidential elections.[2] In 2008, Barack Obama won the White House and helped House Democrats win the nationwide popular vote by about 11 percentage points, netting more than 20 seats. More recently, the House popular vote margin nationwide has been closer in presidential election years, and the number of seats gained or lost much smaller. At the moment, Republicans have a small edge in the generic ballot polling, but once again we would caution that much can change between now and November, and even small changes matter when dealing with a House of Representatives that is so evenly divided between the two parties.

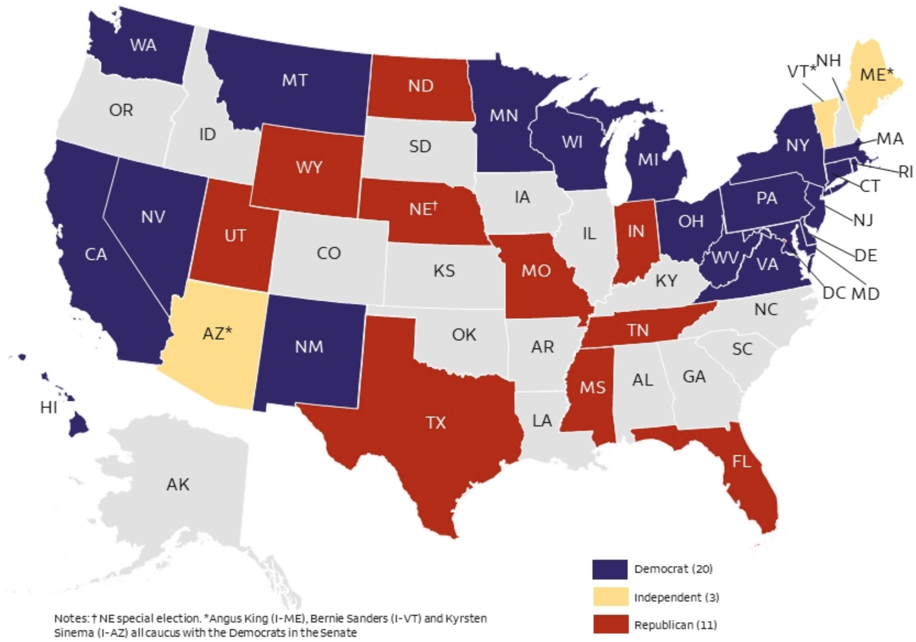
## Control of the Senate: A Favorable Map for Republicans

The outlook for control of the Senate is more unique compared to the House of Representatives. Unlike the House, the entire Senate is not up for election every two years. Instead, Senators are elected to six year terms, and one-third of the Senate is up for election every two years. The Senate is currently split between 49 Republicans, 48 Democrats and 3 Independents. Those three independents all caucus with the Democrats, thus giving the Democrats majority control of the chamber. Republicans need to pick up at least two seats on net to retake control of the chamber. If they pick up just one seat, a 50-50 tie would be decided by the incoming vice president.

***Republicans need to pick up at least two seats on net to retake control of the Senate. If they pick up just one seat, a 50-50 tie would be decided by the incoming vice president.***

Part I: Figure 5

2024 Senate Races

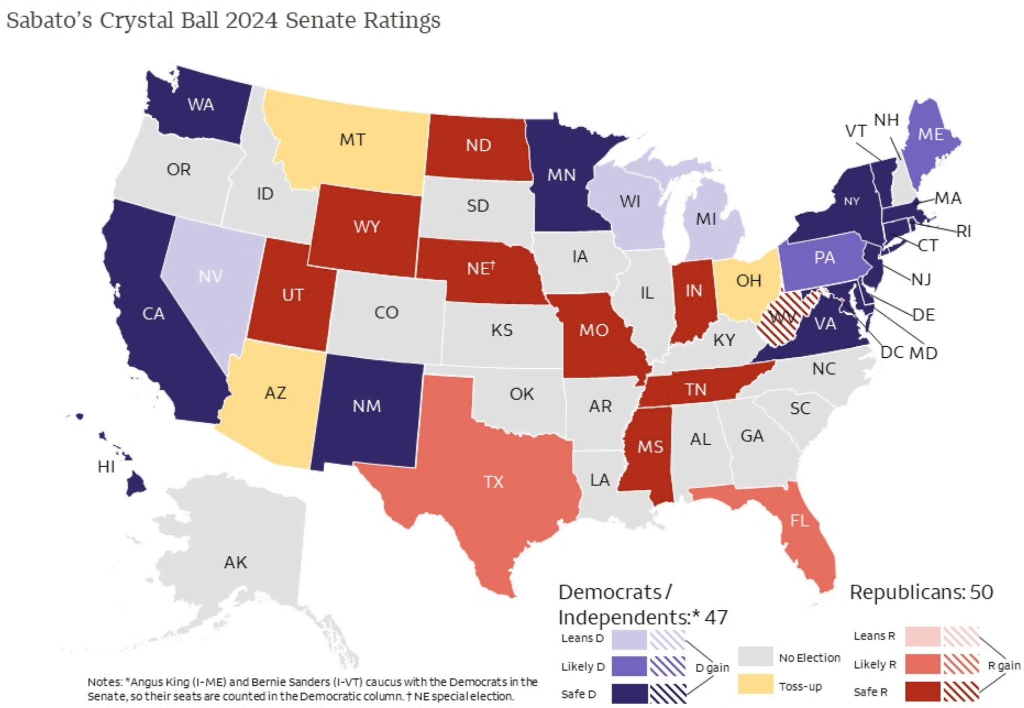



Source: Sabato's Crystal Ball at the University of Virginia Center for Politics and Wells Fargo Economics

Political analysts generally view this year's Senate map as more favorable to Republicans. There are 34 Senate seats up for grabs: 20 are held by Democrats, 11 are held by Republicans and the remaining three are held by the independents who caucus with the Democrats (Figure 5). As a result, Democrats are playing "defense" in more states than Republicans. The seat held by retiring Senator Joe Manchin (D-WV) is up for grabs, and Sabato's Crystal Ball has it rated as a prime pick-up opportunity for Republicans (Figure 6). Democratic Senators also face potentially competitive races in states that Donald Trump won in 2020 (Montana, Ohio) as well as races in states that were tight at the presidential level in 2020 (Wisconsin, Nevada, Arizona, Michigan, Pennsylvania). On the Republican side, most political forecasters envision fewer pick-up opportunities for Democrats. Republican senators up for re-election in Florida and Texas represent Democrats' best chances of flipping a couple of seats. The race for control of the Senate remains a long way from over, but this year's map affords Republicans more opportunities for the much-coveted 51st seat.

***Political analysts generally view this year's Senate map as more favorable to Republicans.***

Part I: Figure 6




Source: Sabato's Crystal Ball at the University of Virginia Center for Politics and Wells Fargo Economics

## A Long Road to November

It appears highly likely that the 2024 presidential election will be a rematch featuring incumbent President Joe Biden and former President Donald Trump. Much can change between now and Election Day on November 5, and it likely will be several months before the state of the race comes into sharper focus. That said, we will be keeping an eye on head-to-head polls, approval ratings, prediction markets, forecasts of top political analysts and, of course, economic conditions to monitor the race. Although the race for the White House likely will garner the most attention, we believe it is critical to also focus on the outlook for control of Congress. In recent years, unified government has produced much of the major legislation that has driven shifts in the economic outlook. Republicans currently hold a razor-thin majority in the House of Representatives, and as a result Democrats need to net just a handful of seats to flip control of the House. In the Senate, Republicans need to pick up just two seats on net to gain a majority, and this year's Senate races afford them plenty of opportunities to do so. We will keep our readers updated as this year's elections develop. Stay tuned.

***Much can change between now and Election Day on November 5, and it likely will be several months before the state of the race comes into sharper focus.***

## Endnotes

1 – See Sabato's Crystal Ball at the University of Virginia Center for Politics 2024 Electoral College ratings. (Return)

2 – Bear in mind that, unlike in some parliamentary systems, winning the national popular vote at the Congressional level does not necessarily translate directly into a majority. The 'first-past-the-post' system, as well as the drawing of Congressional districts, can impact the actual number of seats won. Generally speaking though, the popular vote margin is a solid proxy for number of House seats captured. (Return)

(Return to overview)

## Part II: Monetary Policy Implications

*Published on February 20, 2024*

### Summary


- The FOMC continues to face a difficult economic environment. Inflation has yet to recede all the way back to the Committee's 2% target, while resilient economic growth has stoked concerns it may prove more challenging to fully rein in price growth. Yet, with monetary policy restrictive and the lagged impact on the economy a major source of uncertainty, the risk of recession remains unusually high in our view.
- Amid these economic crosswinds looms the U.S. presidential election. Chair Powell has steadfastly declared that politics will not play a role in the FOMC's policy decisions.
- We agree with Chair Powell's message that the election will not be a major factor in monetary policy setting this year. When looking at the history of Fed policy changes in presidential election and non-election years over the past 30 years, economic conditions overwhelmingly dominate policy decisions across the following dimensions:
    - *Number of Policy Moves:* The Fed has adjusted its policy rate nearly the same number of times in presidential election years as non-election years (an average of 2.7 and 2.9 times, respectively).
    - *Direction of Policy Moves:* The FOMC has *cut* the fed funds rate by 46 bps on average in presidential election years while *raising* it by 25 bps on average in non-election years. However, these differences effectively disappear when excluding years in which the economy was in a recession (2001, 2008, 2020).
    - *Timing of Policy Moves:* Looking across presidential election years shows the Fed has tended to maintain its charted course through the election, whether that be tightening (2004), cutting (2008) or remaining on hold (1996, 2012, 2020).
- Even if monetary policymakers wanted to help one party over the other, which we do not believe is the case, it is not entirely clear which way they should lean. The delicate balancing act between reducing inflation—a prominent issue for voters this year—without causing untoward damage to the jobs market—a perennial issue for voters—remains. In the words of Chair Powell in his recent 60 Minutes interview: “it's not easy to get the economics of this right in the first place.”
- This is not to say presidential elections have no implications for the monetary policy outlook. Changes in the composition of Congress and the White House, such as the Republican sweep in 2016, can lead to inflection points for federal fiscal policy, and, by extension, the outlook for the U.S. economy and monetary policy.
- Furthermore, the president and Senate play a key role in determining the makeup of the Board of Governors. Jerome Powell's term as FOMC Chair ends in May 2026, while the four-year terms of Board of Governors Vice Chair Philip Jefferson and Vice Chair of Supervision Michael Barr will also expire during the next administration (in September 2027 and July 2026, respectively).
- Our forecast for the federal funds rate in 2024 will be dictated primarily by our expectations for U.S. economic growth, employment and inflation and our view of the Fed's reaction to these developments. We do not think the election will play a major role in driving monetary policy decisions at the five FOMC meetings between now and Election Day. The Federal Reserve takes its independence very seriously, and the past 30 years of history suggests that macroeconomic conditions are the dominant force guiding monetary policy.


### Welcome to the 2024 Election Cycle

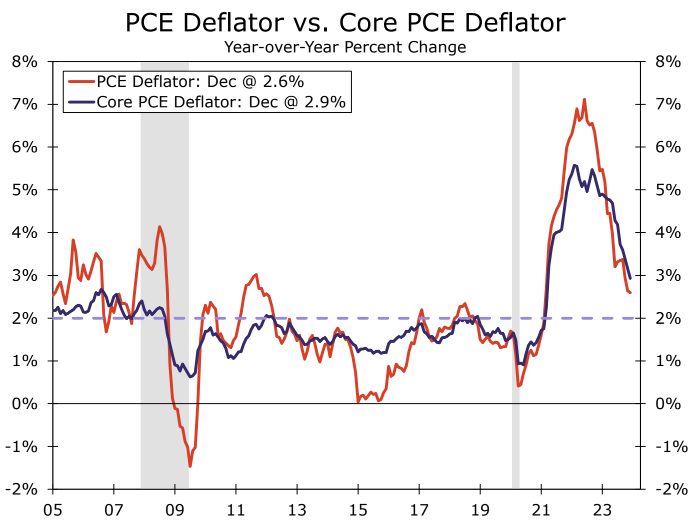
The 2024 election cycle has arrived, and with it questions about what the election means for the economic outlook. In Part I of our series on the U.S. presidential election and its implications for the U.S. economy, we provided some background on this year's election. In this report, which is Part II in the series, we review what history tells us about Federal Reserve monetary policy decisions in election years.

"A highly consequential year for, for the Fed and for monetary policy"[1]

Amidst the election buzz news cycle, the Federal Reserve is in its third year of working to smite the strongest bout of inflation in more than 40 years. Inflation has retreated from its high reached in the summer of 2022, but it has yet to recede all the way back to the FOMC's target, let alone stay there on a sustained basis (Figure 1). Thus far, the improvement on inflation has come without a material hit to economic growth. Real GDP rose 3.1% over the past year, while nonfarm payrolls have increased by an average of 244K the past 12 months—both comfortably above the previous expansion's average and most estimates of their longer-run potential pace (Figure 2). The resilient growth backdrop has stoked concerns that inflation may prove somewhat sticky even as it recedes from the sky-high rates experienced the past couple years. Yet, with monetary policy restrictive by nearly all accounts and the lagged impact on the economy a major source of uncertainty, the risk of recession remains unusually high in our view. As such, the FOMC faces a complicated macro environment as it determines its next move.

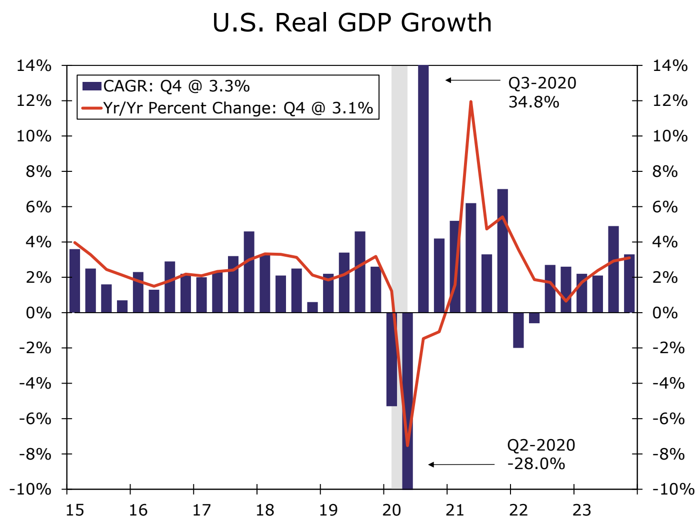
***The FOMC faces a complicated macro environment as it determines its next move.***

Part II: Figure 1




Source: U.S. Department of Commerce and Wells Fargo Economics

Part II: Figure 2




Source: U.S. Department of Commerce and Wells Fargo Economics

In addition to these macroeconomic crosswinds, the Federal Reserve faces another wrinkle in the outlook: the U.S. presidential election. Chair Powell has faced media inquiries questioning if politics will play any role in the central bank's decisions this year. His answer steadfastly has remained no. In a recent interview with 60 Minutes, Powell stated "We do not consider politics in our decisions. We never do. And we never will."[2]

***We expect the Fed will respond to incoming data, not political influences, as it pursues its dual mandate in 2024.***

We believe Powell's message that the looming election will not play a major role in determining the path of the federal funds rate this year. In this report, we walk through three potential impacts the U.S. 2024 election cycle could have on monetary policy in 2024: (1) the *number* of fed funds rate moves; (2) a *directional* bias to rate moves; and (3) the *timing* of policy actions. The historical record can shed light on each of these concerns and suggests to us that, given the myriad of economic forces with which the central bank must contend, the election is mostly noise. Accordingly, we expect the Fed will respond to incoming data, not political influences, as it pursues its dual mandate in 2024.

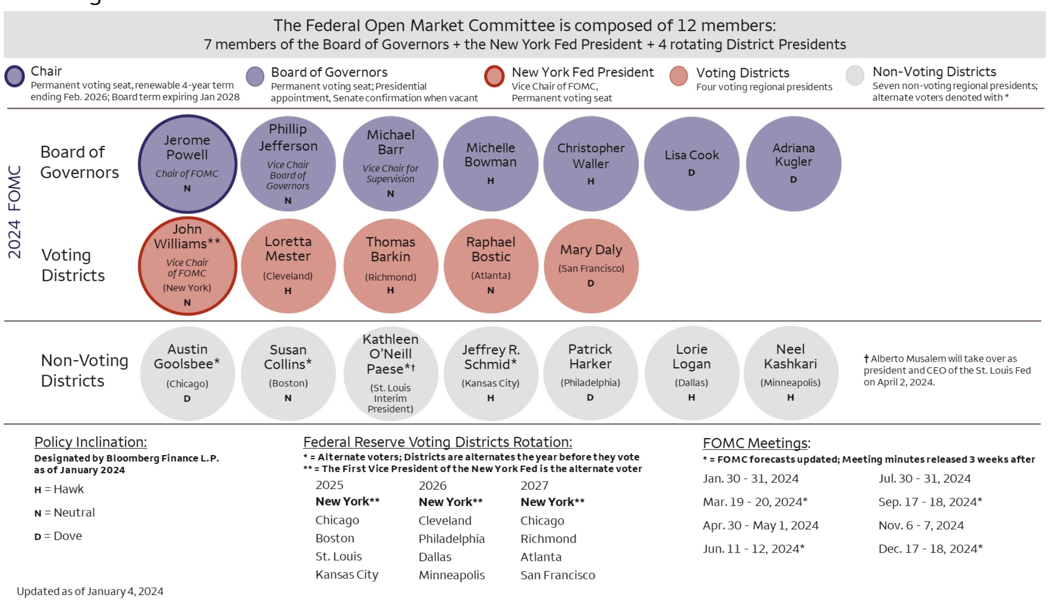
This is not to say, however, that elections have no impact on the outlook for monetary policy. Changes in the composition of Congress and the White House can lead to inflection points for federal fiscal policy, and, by extension, the outlook for the U.S. economy and monetary policy. Furthermore, the president and Senate play a key role in determining the makeup of the Board of Governors, and this process shapes the intellectual leaders of the central bank. The 2024 election likely will not be the driving force behind the Fed's moves at its upcoming meetings, but it will still have important implications for monetary policy in 2025 and beyond. We discuss these implications below.

"We haven't done it in the past, and we're not going to do it now."[3]

Created in 1913, the Federal Reserve is an independent government agency, but it is ultimately accountable to the public and its elected officials. The central bank is designed in a way to maintain this public accountability while also protecting Fed officials' independence to ensure that central bankers are not unduly influenced by political pressures that yield undesirable economic outcomes. The FOMC consists of the seven members of the Board of Governors, the president of the Federal Reserve Bank of New York, and four of the remaining eleven Reserve Bank presidents, who serve one-year terms on a rotating basis (Figure 3). Governors are appointed by the President of the United States and confirmed by the Senate to terms lasting 14 years. The presidents of the twelve regional Reserve Banks are not selected by the U.S. president but rather by the directors of each Reserve Bank. The Federal Reserve is self-funded and does not receive appropriations through the Congressional budget process.

***The Federal Reserve is an independent government agency, but it is ultimately accountable to the public and their elected officials.***

Part II: Figure 3




Source: Bloomberg Finance L.P., Federal Reserve System and Wells Fargo Economics

This unique setup helps ensure that the Federal Reserve can focus on achieving the goals set forth by Congress, namely maximum employment and stable prices. That said, like many other government organizations advancing the public interest, there is clearly a political tie to the Federal Reserve. Congress can change the central bank's mandates at anytime, and the selection process for the Board of Governors involves the president and Senate. For example, Chair Powell was initially nominated to the Board by President Obama in 2012. President Trump elevated Powell from Governor to Chair in 2018, and President Biden nominated him for a second term as Chair in 2022.

***When charting a course for the nation's monetary policy, central bank independence is a bedrock principle of the Federal Reserve.***

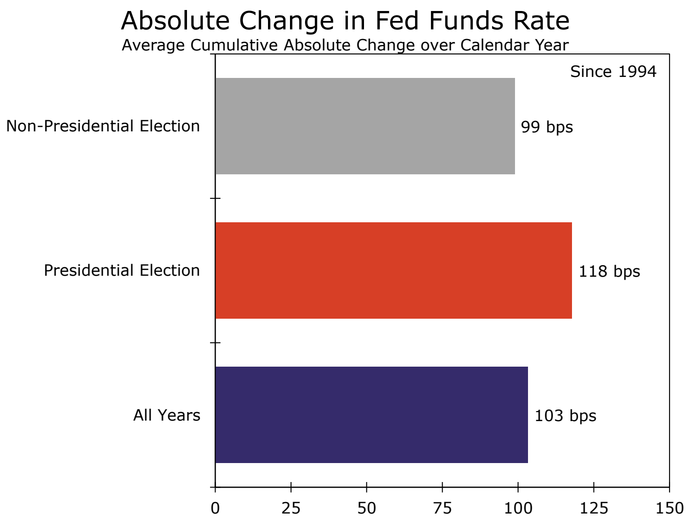
When charting a course for the nation's monetary policy, central bank independence is a bedrock principle of the Federal Reserve.[4] When asked in a recent 60 Minutes interview whether politics will be a determinant in setting policy this year, Powell supported his unequivocal 'no' and 'never' answer with the statement, "Fortunately, the historical record really backs that up. People have gone back and looked."

Reviewing what history tells us about Federal Reserve monetary policy decisions in election years is admittedly a bit tricky. The relevant window to examine the historical record is actually quite short. There are only 19 presidential election cycles post-WWII, and even fewer that are comparable years for the current monetary policy setting environment. The Great Inflation plagued policymakers from 1965 to 1982 and was characterized by "go-stop" policy, which led to volatility in rates and price growth.[5] Furthermore, the Fed was significantly less transparent before the 1990s. Prior to 1994, it did not announce its policy changes, and it was not until 2000 the Committee issued a statement after each meeting indicating whether it had changed policy or not. Post-meeting press conferences first began in 2011 under Chairman Ben Bernanke and were expanded to every meeting under Chair Powell in

2019. With this in mind, we focus our analysis of presidential election years and the path of monetary policy on the past 30 years.

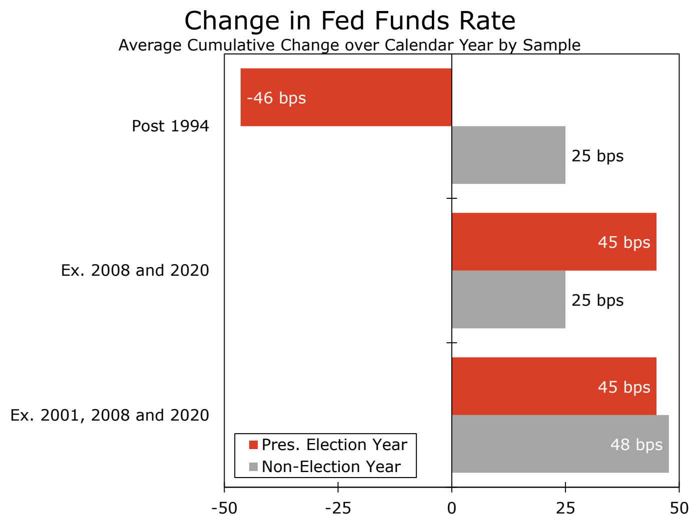
"This is my fourth presidential election in the Fed, and it just doesn't come into our thinking."[6]
The first concern we explore is whether monetary policymakers tend to refrain from policy adjustments during election years. The argument goes something like this: in an effort to demonstrate the Fed's independence and guard against criticism that moves are politically motivated, policymakers may not change its policy rate as much as they otherwise would have. However, in the past 30 years, the Fed has actually moved rates slightly *more* in presidential election years compared to non-election years, by about 20 basis points more on an absolute basis (Figure 4). Since 1994, the average number of times the FOMC adjusted the fed funds rate each year is nearly identical across election (2.7 instances) and non-election (2.9 instances) years.

Part II: Figure 4




Source: Bloomberg Finance L.P. and Wells Fargo Economics

Part II: Figure 5




Source: Bloomberg Finance L.P. and Wells Fargo Economics

"We are a non-political organization that serves all Americans"[7]
A second question we are sometimes asked is whether the Fed's policy actions in election years are biased to support a particular candidate—usually the incumbent, who may have appointed/re-appointed the Fed chair and other top Board officials. This suggests a potential bias toward easier policy to lend near-term support to the economy. Indeed, in the seven presidential election years since 1994, the FOMC has *cut* the fed funds target rate by an average of 46 basis points compared to *raising* the fed funds rate by an average of 25 basis points during non-election years (Figure 5).

***Excluding recession years in our analysis shows the FOMC adjusting the fed funds rate by similar amounts: +45 bps in election years and +48 bps in non-election years.***

However, with so few periods to examine—seven presidential election years and 23 non-election years—it is not surprising that these simple averages are skewed by major economic events. For example, the FOMC slashed rates in the presidential election years of 2008 and 2020 as the economy was plunging into recession from a global financial crisis and a global health crisis, respectively. Excluding 2008 and 2020, the FOMC has, on average, *raised* the fed funds rate more in election years compared to non-election years (see Figure 5). Fully excluding recession years in our analysis (2001, 2008 and 2020) shows the FOMC adjusting the fed funds rate by similar amounts: +45 bps in election years and +48 bps in non-election years. Macroeconomic conditions, rather than the election cycle, seem to dominate the direction of policy moves.

***The past 30 years of history suggest that macroeconomic conditions, rather than the election cycle, seem to dominate the direction of monetary policy moves.***

"Integrity is priceless. And at the end, that's all you have. And we in, we plan on keeping ours."[8]
The third concern, and the one we think warrants the most thought, is whether the FOMC may adjust the timing of its policy actions this year because of the election. In an effort to avoid the political fray, the Committee may be reluctant to make a significant policy adjustment—such as a pivot to cuts—when the campaign season is hitting a fever pitch. Looking across election years shows the FOMC rarely changes course immediately ahead of voting day. Instead, the Fed has tended to maintain its charted course through the election, whether that be tightening (2004), cutting (2008) or remaining on hold (1996, 2012, 2020) (Figure 6).

Part II: Figure 6

**Moves in the Fed Funds Rate around Election Day**
Cumulative Change From Meeting to Election Day

| | | 1996 | 2000 | 2004 | 2008 | 2012 | 2016 | 2020 | Average |
|---|---|---|---|---|---|---|---|---|---|
| **One Meeting** | Pre-Election | 0.00 | 0.00 | 0.25 | -0.50 | 0.00 | 0.00 | 0.00 | -0.04 |
| | Post-Election | 0.00 | 0.00 | 0.25 | -0.75 | 0.00 | 0.25 | 0.00 | -0.04 |
| **Two Meetings (Approx. One Quarter)** | Pre-Election | 0.00 | 0.00 | 0.50 | -1.00 | 0.00 | 0.00 | 0.00 | -0.07 |
| | Post-Election | 0.00 | 0.00 | 0.50 | -0.75 | 0.00 | 0.25 | 0.00 | 0.00 |
| **Four Meetings (Approx. Six Months)** | Pre-Election | 0.00 | 0.50 | 0.75 | -1.00 | 0.00 | 0.00 | 0.00 | 0.04 |
| | Post-Election | 0.25 | -2.00 | 1.00 | -0.75 | 0.00 | 0.50 | 0.00 | -0.14 |

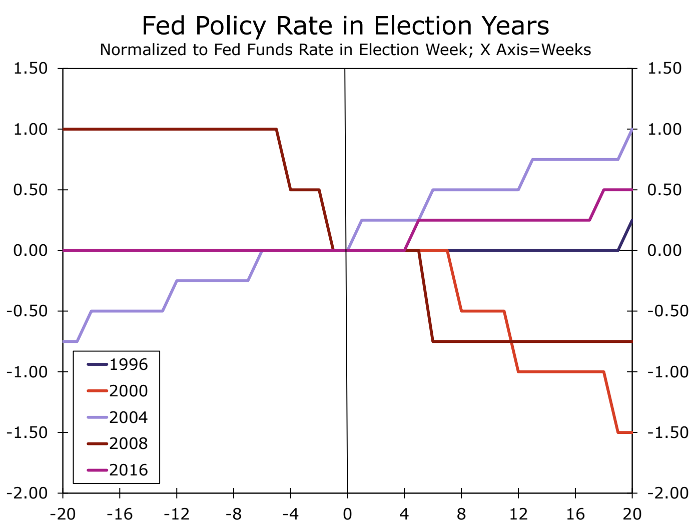
Source: Bloomberg Finance L.P. and Wells Fargo Economics

*Shortly after the 2000 election the FOMC pivoted to cutting rates, but this occurred amid a recession that officially began in March 2001.*

There are a few exceptions to this pattern. In 2000, the FOMC held rates unchanged at the three meetings that preceded the election and for the two meetings following, but then the Committee embarked on a series of rate cuts in early 2001 (Figure 7). However, this pivot occurred as the economy started to show early signs of a slowdown, and by March 2001 the U.S. economy was officially in recession.[9] In December 2000, the unemployment rate was a low 3.9%. One year later, it had climbed to 5.7%, illustrating once again that economic conditions seem to dominate Fed decision-making.

In 2016, after holding rates unchanged for nearly a year, the FOMC raised the fed funds target rate by 25 bps at the meeting immediately following the election. A review of the transcript from the pre-election meeting signals that policymakers were reluctant to change course right before the election at a meeting that did not have a press conference and with no pressing economic need to do so. During the November 2, 2016 FOMC meeting, then New York Fed President and Vice Chair William Dudley stated in regard to the fed funds rate: "So the lack of urgency implies that there is not a good case for moving at this meeting. To do so with the election a week away, the outcome uncertain, and no scheduled press conference would imply an urgency to move that I just don't think is consistent with the incoming information or the economic outlook."

Part II: Figure 7




Source: Bloomberg Finance L.P. and Wells Fargo Economics

## Election Timing May Mean Little, but Election Outcomes Can Mean A Lot

***Elections still matter for the fiscal backdrop in which monetary policy must operate.***

The 2016 episode also highlights that, while the Fed may want to avoid making waves by shifting the path of policy immediately ahead of an election, elections still matter for the fiscal backdrop in which monetary policy must operate. Republicans won control of the House of Representatives, the Senate and the White House in the 2016 election, marking their first period of unified control of Congress and the presidency since 2005-2006. Financial markets reacted sharply in anticipation of potential fiscal policy stimulus delivered through lower taxes. Between the November and December FOMC meetings, the S&P 500 rose more than 7%, spreads on corporate bonds tightened and the 10-year Treasury yield rose from 1.8% to 2.5%.

At the FOMC meeting immediately following the 2016 election, the fiscal policy outlook and its implications for the economic outlook became a greater point of discussion. A word count of the transcript from the November 2016 FOMC pre-election meeting reveals that the word "fiscal" was mentioned 17 times over the two-day meeting. This word count exploded to 212 times at the subsequent meeting in December 2016. It was not just markets that began to recalibrate the outlook to include more expansionary fiscal policy. The Federal Reserve's staff economists incorporated fiscal policy accommodation into its baseline outlook, and about half of FOMC participants assumed more fiscal stimulus in their submitted forecasts for the Summary of Economic Projections.[10]

A similar dynamic was at play in 2012. At the time, the U.S. economy was still struggling to achieve escape velocity from the 2008-2009 financial crisis. The unemployment rate was near 8% on Election Day, and the federal funds rate remained at the zero lower bound, where it had been since December 2008. Policymakers fretted that a slew of federal spending cuts and tax increases scheduled to take effect absent Congressional action, commonly referred to as a looming “fiscal cliff,” could derail the recovery further. At the December 2012 FOMC meeting, Vice Chair Dudley expressed the view that the Federal Reserve would need to adjust monetary policy depending on the outcome of the negotiations: “If the fiscal situation was resolved in a good way, I can imagine we could dial back on some portion of our securities purchase program pretty soon. But with a bad outcome, if we go down the wrong path in terms of fiscal cliff, I think the programs would have to remain in place for some time.” Jerome Powell, then a Governor on the Board, expressed a view that “All in all, it could be as much as a full year—and I suppose even more—of very messy negotiations, and that will mean further blows to consumer and business confidence, a global risk-off environment, and a strong dollar.” Clearly, the *outcomes* of the 2012 and 2016 elections had an impact on the thinking of monetary policymakers.

## What Does This Mean for 2024 and Beyond?

***Even if monetary policymakers wanted to help one party over the other (which, to reiterate, we do not believe is the case), it is not entirely clear which way they should lean.***

While the recent historical record suggests that presidential elections have little bearing on the magnitude, direction and timing of FOMC policy moves in the lead up to Election Day, is there reason to believe this cycle may be different? We are skeptical it is, even as politicians on both sides of the aisle seem more vocal lately about what they would like the FOMC to do.

The Fed's delicate balancing act between reducing inflation without causing untoward damage to the jobs market remains. Thus, even if monetary policymakers wanted to help one party over the other (which, to reiterate, we do not believe is the case), it is not entirely clear which way they should lean. If the FOMC were to expedite rate cuts, the jobs market would presumably be stronger ahead of voting day, but so too would inflation, a prominent issue for voters. Delaying rate cuts would likely help to reduce inflation further and mitigate voters' frustration about the inflation environment, but it could come at the expense of the jobs market, most voters' means of income. In the words of Chair Powell in his recent 60 Minutes interview: “it's not easy to get the economics of this right in the first place.”

***We do not think the election will play a major role in driving monetary policy decisions at the five FOMC meetings between now and Election Day. That said, the outcome of the election will have implications for U.S. monetary policy in 2025 and beyond.***

Our forecast for the federal funds rate in 2024 will be dictated primarily by our expectations for economic growth, employment and inflation and our view of the Fed's reaction to these developments. We do not think the election will play a major role in driving monetary policy decisions at the five FOMC meetings between now and Election Day. The Federal Reserve takes its independence very seriously, and the past 30 years of history suggests that macroeconomic conditions are the dominant force guiding monetary policy.

That said, the *outcome* of the election will have implications for U.S. monetary policy in 2025 and beyond. The next president will have the opportunity to shape the FOMC through appointments to the Board of Governors. Jerome Powell's term as FOMC Chair ends in May 2026, while the four-year terms of Board of Governors Vice Chair Philip Jefferson and Vice Chair of Supervision Michael Barr will also expire during the next administration (in September 2027 and July 2026, respectively). While all three *could* stay on at the Board of Governors in non-leadership roles, typically Governors depart at the conclusion of their various leadership roles. Governor Adriana Kugler's term also will expire in 2026. Furthermore, the historical record shows that, once an election has been decided, the FOMC takes into account what economic policy initiatives the incoming Congress and president may undertake. In Part III of this series, we will examine some key fiscal policy areas that will be impacted by this year's election outcome.

## Endnotes

1 – Quotation from Chair Powell at the post-meeting press conference on January 31, 2024. (Return)

2 – See the full transcript of Chair Powell's 60 Minutes interview with Scott Pelley. The interview took place on February 1, 2024 and was aired on February 4. (Return)

3 – See Endnote 2. (Return)

4 – For further reading on the history and evolution of the independence of the Federal Reserve, see "The Evolution of Fed Independence" by Stephen Slivinski at the Federal Reserve Bank of Richmond (2009). (Return)

5 – See Michael Bryan (2013). "The Great Inflation." Federal Reserve Bank of St. Louis: Federal Reserve History. (Return)

6 – See Endnote 2. (Return)

7 – See Endnote 2. (Return)

8 – See Endnote 2. (Return)

9 – The January 3, 2001 statement explaining the inter-meeting decision to cut noted that "These actions were taken in light of further weakening of sales and production, and in the context of lower consumer confidence, tight conditions in some segments of financial markets, and high energy prices sapping household and business purchasing power." (Return)

10 – See the transcripts from the November 1-2, 2016 meeting and the December 13-14, 2016 meeting. (Return)

(Return to overview)

## Part III: Fiscal Policy Implications

*Published on March 4, 2024*

### Summary


- The 2024 U.S. election will determine who is in charge of Congress and the White House come January 2025, which will have critical implications for the federal fiscal policy outlook, and by extension, the U.S. economic outlook.
- The debt ceiling will be reinstated on January 2, 2025. Our base case is the "X date" (the date when Treasury would be unable to meet all its obligations on time) falls in the summer of 2025. However, there is a risk it falls as early as February 2025.
- The looming expiration of large parts of the Tax Cuts and Jobs Act (TCJA) at year-end 2025 will be the most important post-election fiscal policy topic, in our view. The TCJA was enacted in 2017 and reduced taxes for individuals and businesses alike. Though most of the changes for corporations were made permanent, many of the tax changes for individuals and smaller businesses are scheduled to expire.
- The fiscal cost of extending the TCJA is sizable and comes at a time when budget deficits are already quite large. The Congressional Budget Office estimates that fully extending the TCJA's expiring provisions would cost $3.5 trillion over the next decade, amounting to deficits that are 1.0-1.5% of GDP larger per year. A one percentage point increase in the structural budget deficit is associated with an increase in longer-term yields on Treasury securities of roughly 15-30 bps, all else equal.
- Allowing the TCJA to expire would improve the budget imbalance, but it would likely come with some short-run pain. We doubt that the expiration of the TCJA would be enough to push the economy into a recession single-handedly, but it could knock a few tenths of a percentage point off growth and inflation in 2026.
- There is significant uncertainty about the impact of tax policy changes that may or may not take effect in 2026. That said, we want to give readers some rough guideposts on our initial thoughts.
  - *Republicans sweep*: A Republican sweep seems most likely to result in extending the 2017 tax cuts. An *expansion* of the cuts is more uncertain but strikes us as plausible. Should it occur, more fiscal stimulus should be associated with somewhat faster economic growth, higher inflation, larger budget deficits, higher Treasury yields and a steeper yield curve, all else equal.
  - *Divided government*: We view a Republican president/Democratic Congress (or vice versa) as the election outcome most likely to yield some fiscal policy tightening on the margin. A partial expiration of the TCJA probably would modestly depress the 2026 outlook for growth, inflation, government borrowing and yields.
  - *Democrats sweep*: A sweep by the Democrats could also lead to more fiscal policy accommodation, but we suspect Democrats are more inclined to offset new policy initiatives with higher taxes, particularly for higher-earning households and corporations. From an accommodation standpoint, we view this scenario as somewhere between the Republican sweep and divided government scenarios.
- Serious long-run fiscal challenges are likely to remain regardless of the 2024 election outcome. Even if the TCJA expires in full as scheduled, federal budget deficits are poised to remain wide in the years ahead (5-6% of GDP) in the absence of even higher federal taxes, entitlement reform or much lower interest rates.


### Welcome to the 2024 Election Cycle

The 2024 election cycle has arrived, and with it have come questions about what the election means for the U.S. economic outlook. In Part I of our series on the U.S. presidential election and its implications for the economy, we provided some background on this year's election. In Part II, we reviewed what history tells us about Federal Reserve monetary policy decisions in election years and discussed how election outcomes impact the FOMC. In this report, we explore the post-election fiscal policy outlook. Specifically, we examine the timeline for the next debt ceiling showdown, the outlook for the annual budget process and the economic implications of the looming expiration of large parts of the Tax Cuts and Jobs Act (TCJA).

## The First Order of Business: The Nuts and Bolts of Governing

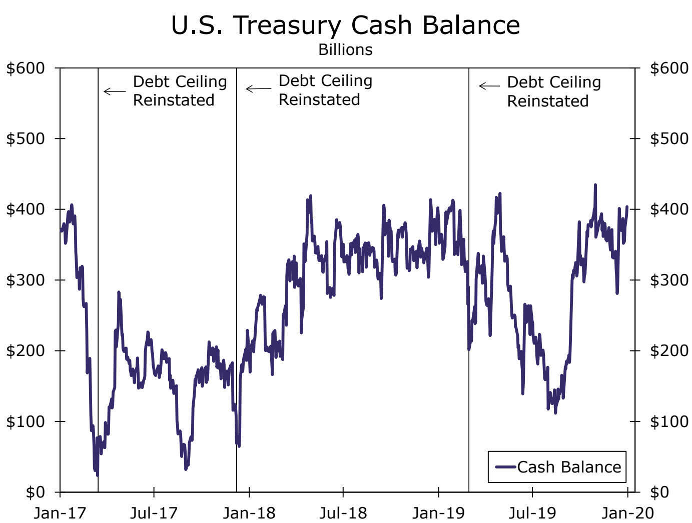
### Happy New Year. Now Deal with the Debt Ceiling.

When the 119th Congress convenes for the first time in January 2025, one of the first orders of business will be dealing with the debt ceiling. As a reminder, the debt ceiling (also known as the debt limit) is a legal limit on the total amount of outstanding debt for the federal government. Since the federal government's revenues are generally less than its outlays, the debt ceiling must be increased periodically to accommodate additional borrowing. The debt ceiling was suspended in June 2023 as part of the Fiscal Responsibility Act (FRA). The FRA suspended the debt ceiling until January 2, 2025, at which point it will be reinstated at the prevailing public debt level on that date. Unless Congress acts in advance of January 1, the U.S. Treasury will need to tap its cash balance and employ "extraordinary measures" to make up the difference between revenues and outlays.

***Unless Congress deals with the debt ceiling in advance of its scheduled reinstatement on January 2, 2025, the Treasury will need to tap its cash balance and employ "extraordinary measures" to make up the difference between revenues and outlays.***

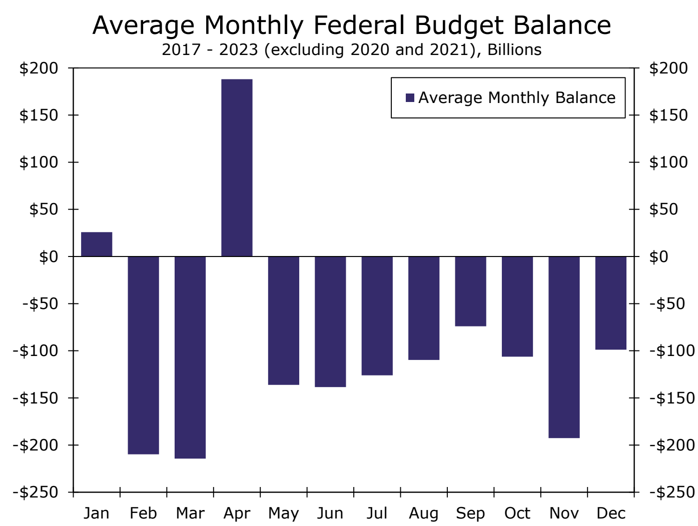
This far out, it is not possible to forecast the "X date," or the date on which the Treasury would be unable to meet all of its obligations on time, with much precision. Uncertainty about the economic and fiscal outlook creates a wide range of possible outcomes. In addition, it remains unclear to us whether Treasury will need to draw down its cash balance in advance of the January 2 debt ceiling reinstatement. The FRA states that the Treasury shall not issue debt for the purpose of increasing its cash balance above "normal operating balances." Our best guess is that the Treasury will be able to maintain business as usual when it comes to running its cash balance in the $700-$800 billion range through year-end. However, there have been instances over the past decade when Treasury felt legally compelled to rapidly reduce its cash balance in the days ahead of a debt ceiling reinstatement (Figure 1). If this were to occur, Treasury could reduce its cash balance down to the ~$50 billion level that prevailed when the FRA was enacted in June 2023. We await further guidance from Treasury on this topic.

Part III: Figure 1




Source: Bloomberg Finance L.P. and Wells Fargo Economics

Part III: Figure 2




Source: U.S. Department of the Treasury and Wells Fargo Economics

If Treasury *does not* reduce its cash balance to low levels and instead finishes 2024 with its cash balance near current levels (about $750 billion), we suspect the hard deadline for action on the debt ceiling will fall sometime in the summer of 2025. If Treasury *does* reduce its cash balance back to the low level that prevailed in June 2023 when the FRA became law, the "X date" could occur as early as February 2025. February and March typically see large seasonal deficits as income tax refunds are sent out, and under this scenario we doubt Treasury would have the funds necessary to remain solvent until the seasonal April budget surplus (Figure 2).

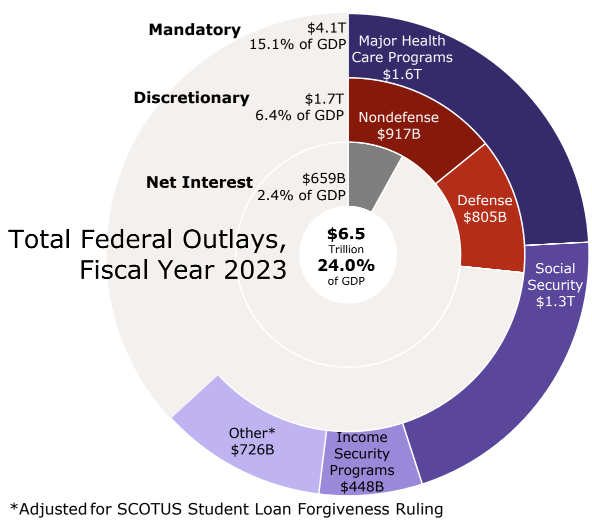
***Our base case is that the "X date" falls in the summer of 2025, but there is a risk it could be as early as February 2025.***

### Appropriations Drama Not Going Away

The incoming Congress will also need to tackle the annual budget. Each year, Congress passes 12 appropriation bills that account for roughly 25% of federal spending. This segment of the federal budget is often referred to as "discretionary" spending given that Congress must appropriate the funds each fiscal year (Figure 3). In contrast, "mandatory" spending is not set during the annual appropriations process. Instead, the level of mandatory spending is dictated by a variety of eligibility requirements, such as income or age. Medicare, Medicaid and Social Security are examples of mandatory spending programs.

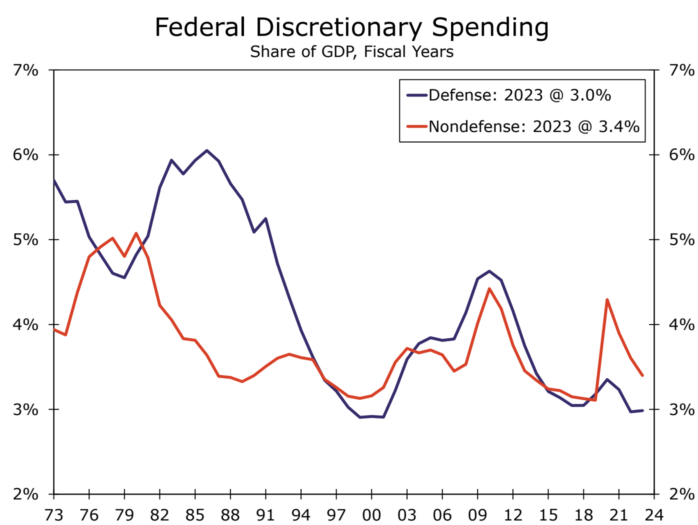
The annual appropriations process for fiscal year (FY) 2024, which began on October 1, has been plagued by challenges. The FRA set caps on defense and nondefense discretionary spending for FY 2024, with defense spending getting about a 3% boost and nondefense spending held roughly flat compared to FY 2023. However, House Republicans' razor-thin majority (219 Rs and 213 Ds at present), internal divisions over the FRA and other political tensions have held up the appropriations process. As we go to print, none of the 12 appropriation bills have become law for FY 2024. Congress has resorted to a series of continuing resolutions to keep the government open and running. FY 2025, which is just seven months away and will begin right before the election, looms as yet another hurdle, as does the ongoing debate about whether to provide supplemental funding for Ukraine, Israel, Indo-Pacific allies and border security.

Part III: Figure 3




Source: Congressional Budget Office and Wells Fargo Economics

Part III: Figure 4




Source: Congressional Budget Office and Wells Fargo Economics

Our best guess is that Congress will enact a discretionary spending agreement for FY 2024 in the coming weeks, with spending levels roughly in line with the FRA. The impact on the economic outlook of such a move would be negligible and is already baked into our forecast. For FY 2025, it would not surprise us if Congress passes a continuing resolution this fall that punts the FY 2025 decisions until after the election. This would tee up a broader negotiation on discretionary spending and the debt ceiling for the lame duck session of Congress or the new one that will begin in January.

***Regardless of the election outcome, budget pressures emanating from tax cuts and rising mandatory spending are likely to keep discretionary spending growing at a relatively modest pace in the coming years.***

Regardless of the election outcome, discretionary spending generally has been on a downward trajectory as a share of the economy in recent years. At 3% of GDP, spending on national defense is near the lows of the past half century, and nondefense spending is set to reach a similar level in FY 2024 and FY 2025 as the pandemic-induced spending bump continues to fade (Figure 4). In our view, the budget pressures emanating from tax cuts and rising outlays on mandatory spending (more on those later) are likely to keep discretionary spending growing at a relatively modest pace of in the coming years.

## TCJA: The Defining Four Letters of Fiscal Policy in 2025

The fiscal policy agenda item that we believe will most impact the economic outlook is the looming expiration of large parts of the Tax Cuts and Jobs Act (TCJA).[1] The TCJA was enacted in December 2017 under President Donald Trump, and the legislation made sweeping changes to the federal tax code. The corporate income tax rate was reduced from 35% to 21%, individual income tax brackets were slashed across-the-board and the standard deduction was doubled, among numerous other changes. Budget analysts estimated at the time that the law would reduce federal revenues by about $1.5 trillion on net over the following decade.[2]

***The fiscal policy agenda item we believe will most impact the economic outlook is the looming expiration of much of the Tax Cuts and Jobs Act. Large parts of the law have sunset dates at year-end 2025, setting up a miniature "fiscal cliff."***

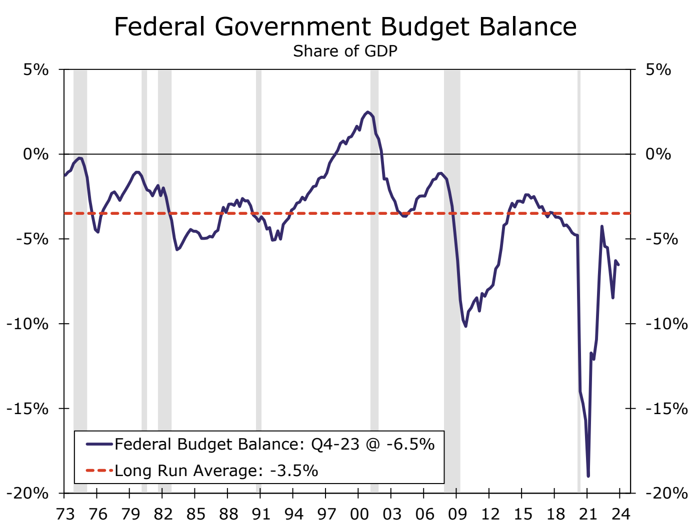
However, large parts of the law are set to expire at year-end 2025, setting up a miniature "fiscal cliff" with which policymakers will need to grapple next year. Democrats did not support the TCJA, and as a result Republicans resorted to a process known as budget reconciliation that allowed them to bypass a Senate filibuster. This approach had the advantage of lowering the threshold for passage in the Senate from a de facto 60 votes to a simple majority of 51, but it came with a major drawback: a reconciliation bill cannot increase the budget deficit *beyond* the budget window (traditionally 10 years). In order to comply with this rule, Republicans sunsetted some of the TCJA for nearly a decade later.

A full list of the expiring provisions in the TCJA can be found here. In short, most of the corporate tax policy changes were made permanent under the TCJA, while many of the changes to the individual income tax code are scheduled to lapse. For example, the reduction in the corporate income tax rate to 21% is not scheduled to change under current law. However, many individual income tax cuts (the lower tax brackets, higher standard deduction, expanded child tax credit, etc.) as well as many individual income tax increases (the elimination of personal exemptions, the cap on the state and local tax deduction, tighter restrictions on mortgage interest deductibility, etc.) are slated to expire in 2025.

***The CBO estimates that fully extending the TCJA's expiring provisions would cost $3.5 trillion over the next decade, inclusive of debt service costs.***

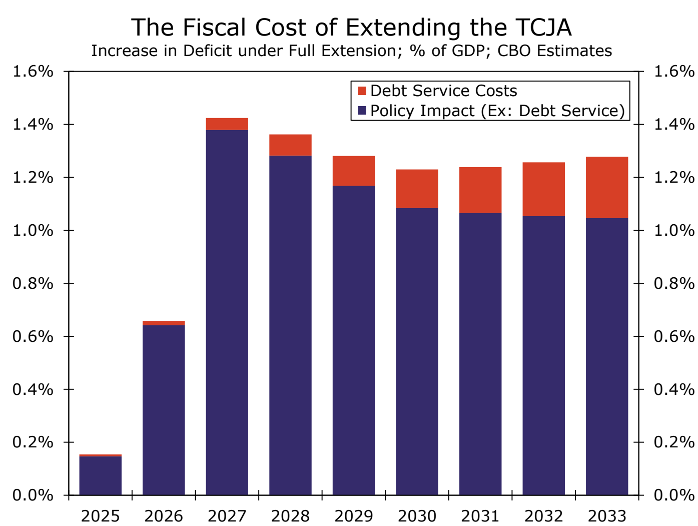
The path forward for tax policy will have important implications for the federal budget and U.S. economy. The fiscal cost of extending the tax cuts is sizable and comes at a time when federal budget deficits are already quite large (Figure 5). The Congressional Budget Office (CBO) estimates that fully extending the TCJA's expiring provisions would cost $3.5 trillion over the next decade, inclusive of debt service costs.[3] Budget deficits would be $400-$500 billion larger per year starting in fiscal year 2027 compared to a baseline that assumes the tax cuts expire as scheduled. This amounts to deficits that are 1.0-1.5% of GDP larger per year (Figure 6). A separate analysis from the Penn Wharton Budget Model projects that federal debt held by the public would be 261% of GDP in 2050 if the tax cuts are extended, compared to 226% of GDP if they are allowed to lapse.[4]

Part III: Figure 5




Source: U.S. Department of the Treasury, U.S. Department of Commerce and Wells Fargo Economics

Part III: Figure 6




Source: Congressional Budget Office and Wells Fargo Economics

Of course, fiscal tightening via higher taxes would improve the budget imbalance, but it would likely come with some short-run economic pain. We doubt that the expiration of the TCJA would be enough to knock the U.S. economy into a recession single-handedly. The U.S. economy avoided a recession in 2013 when the belt tightening from the original “fiscal cliff” was much larger.[5] Furthermore, CBO estimated in 2018 that the tax cuts would boost real GDP growth by about 0.3 percentage points per year in 2018 and 2019, with the positive impulse to growth fading thereafter.[6] Subsequent research suggests CBO's initial estimate likely was in the ballpark.[7] This time around, CBO's baseline economic projections suggest that the *hit* to economic growth from the expiration of the TCJA would be just a couple tenths of a percentage point.[8] A slowdown of this magnitude probably would not cause a recession for an economy that is growing at about 2% per year on trend, although the ultimate outcome will depend on the state of the economy at that point in time.

***We doubt that the expiration of the TCJA would be enough to knock the U.S. economy into a recession single-handedly.***

## Election Scenario Analysis: The TCJA

It is very difficult to project the countless permutations of the tax code that could emerge on the other side of the 2025 deadline. At the micro level, the fortunes of each individual provision of the tax code will be rigorously fought over. At the macro level, there is also significant uncertainty. Sitting in March 2024, we must remain humble about being too precise when discussing the economic impact of tax policy changes that may or may not take effect in 2026. That said, we want to give our readers some rough guideposts and rules of thumb with which to work, and we do believe there are some initial positions that have been staked out on the looming tax policy debate.

*Republicans Sweep*

If Republicans gain control of Congress and the White House, we believe they will make it a priority to protect the TCJA. An extension of the existing tax cuts seems most likely in our view. Given the rules of budget reconciliation, it might once again prove challenging to make these tax cuts permanent. Another sunsetting several years down the road might be needed to remain compliant with budget reconciliation, particularly if Republicans wish to *expand* the TCJA, i.e. make the tax cuts bigger.

It is important to remember that extending the TCJA simply maintains the current policy status quo. Under this scenario, households and businesses will not see any new reduction in their tax burden. Rather, they would just avoid the tax *increases* that would have occurred in the absence of Congressional action. This dynamic may create political pressure to reduce taxes further in order to achieve something new. At a recent rally in South Carolina, Donald Trump suggested that additional tax cuts would be on the table.[9]

***A Republican sweep of Congress and the White House would most likely lead to an extension, and possibly an expansion, of the TCJA.***

Extending the TCJA would be a continuation of current policy and probably would not warrant any major forecast revisions on our part. *Expanding* the tax cuts is far more uncertain and difficult to assess, but if it becomes probable, we would need to incorporate additional fiscal stimulus into our forecast. If realized, these forecast revisions would be largely dependent on the magnitude and structure of the stimulus, in addition to the state of the U.S. economy at that time. More stimulus in an economy with a negative output gap likely would boost economic growth, while more accommodation in an economy with a positive output gap would only stoke more inflation.

On balance, this election scenario strikes us as the most likely one to include more fiscal stimulus, or at least no fiscal tightening. That said, the original TCJA illustrates that even a fairly sizable bill may only move economic growth and inflation forecasts by a few tenths of a percentage point. More fiscal stimulus likely would also be associated with larger budget deficits, higher Treasury yields and a steeper yield curve, all else equal. As we have written previously, a general rule of thumb that emerges from the research literature is that a one percentage point increase in the structural budget deficit is associated with an increase in longer-term yields on Treasury securities of roughly 15-30 bps, all else equal.

*Divided Government*

Under divided government, the two parties will need to work together to handle the looming TCJA expiration. We anticipate that some but not all the TCJA would be extended under a Republican White House and Democratic Congress (or vice versa). Treasury Secretary Janet Yellen has suggested that a second term Biden administration would seek to retain the tax cuts for households earning less than $400,000 per year.[10] A similar dynamic occurred in 2012-2013 during that period's "fiscal cliff" debate. Expiring tax cuts paired with a slew of spending cuts threatened to materially tighten fiscal policy at a time when the unemployment rate was near 8%. Then Vice President Joe Biden helped

***We think a divided government scenario is most likely to yield some modest fiscal tightening.***

negotiate a deal that extended most tax cuts for earners below certain income thresholds, while allowing the tax cuts to lapse for higher earners.

We would expect something similar to occur in 2025 should the election yield a divided government outcome. Some modest fiscal tightening may occur via higher taxes on upper-income households. Under this scenario, we doubt our forecast adjustments would be major, as this outcome is not too much of a departure from the status quo. With so much uncertainty about the specifics and a long way to go until 2026, quantifying the magnitude of such an outcome is difficult. That said, a partial extension of the TCJA along these lines probably would dent economic growth and inflation in 2026 by just a couple tenths of a percentage point. We would expect smaller budget deficits, lower Treasury yields and a flatter yield curve, all else equal, with the magnitude of the change for these variables relatively modest.

*Democrats Sweep*
As we wrote in Part I of our election series, the challenging Senate map for Democrats makes a sweep for the party a steeper hill to climb. That said, Election Day remains a long ways away, and a Democratic sweep is far from impossible. We doubt Democrats would allow the TCJA to completely expire as scheduled. As mentioned earlier, the Biden administration has signaled support for extending the tax cuts for households below a certain income threshold. That said, Democrats may want to pair higher taxes on the wealthy and corporations with additional spending on some of their policy priorities. For example, Democrats could seek to make permanent more generous Affordable Care Act (ACA) subsidies for purchasing health insurance, a current policy in the Inflation Reduction Act that also lapses at year-end 2025.

That said, another bill that is similar to the Inflation Reduction Act probably would not have sweeping implications for our macroeconomic forecast. Higher taxes suggest some fiscal tightening on the margin, but greater spending and/or more generous tax credits for things like purchasing health insurance and green energy development provide an offsetting tailwind. The Biden administration's sizable COVID relief bill, the American Rescue Plan, supercharged the economic recovery and had major implications for the outlook at that time. But, the unusual pandemic-induced circumstances make another such bill unlikely, in our view.

***Even if Democrats sweep on Election Day, we doubt they would allow the TCJA to completely expire as scheduled.***

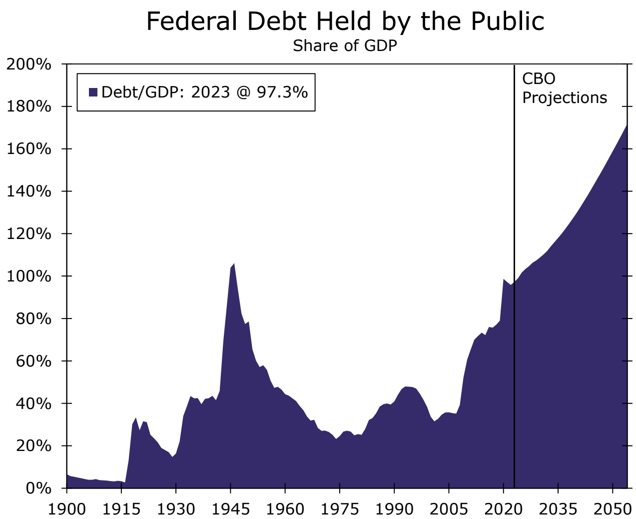
We view the fiscal impact of this scenario as between the Republican sweep and divided government scenarios. Our best guess is that Democrats would extend the TCJA for earners below the $400K income threshold while letting higher tax rates take effect for upper-income earners. These tax increases may be paired with some marginal expansions of spending on Democratic priorities, such as ACA health insurance subsidies and green energy initiatives. On balance, we are skeptical that these policies would have a major impact on our forecasts for economic growth, inflation, budget deficits or Treasury yields in 2026/2027.

## Longer-Run Fiscal Outlook: Challenges Under All Scenarios

Taking a step back, what about the longer-run fiscal outlook? Even if the TCJA expires in full as scheduled, federal budget deficits are poised to remain wide in the years ahead. CBO's baseline 10-year outlook uses current law for its assumptions, and as a result, the expiration of the TCJA is included in its projections. Despite a boost to tax collections starting in 2026, CBO still expects the debt-to-GDP ratio to rise substantially in the years ahead (Figure 7). Federal spending that is above its long-run average is primarily driven by the rising costs of mandatory spending programs such as Social Security and Medicare as well as higher interest costs on the national debt, issues we covered in a recent special report (Figure 8). Neither party's leading candidate for president seem keen on materially reducing mandatory spending growth, and absent even larger increases in federal taxes, federal budget deficits are likely to remain large for the foreseeable future. In a recent interview with 60 minutes, Chair Powell made clear that the “U.S. is on an unsustainable fiscal path.” We agree with that assessment, but based on what we know now, sweeping fiscal reform that would narrow the fiscal imbalance seems unlikely in the aftermath of the 2024 election.

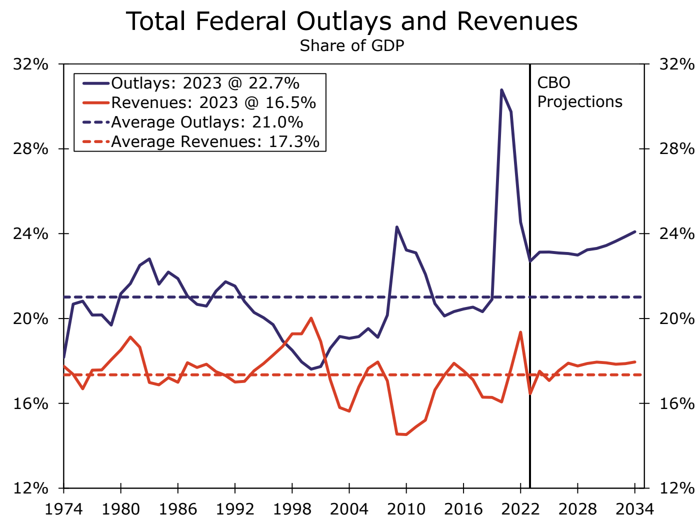
***Neither party's leading candidate for president seem keen on materially reducing mandatory spending growth. Absent even larger increases in federal taxes, federal budget deficits are likely to remain large for the foreseeable future.***

Part III: Figure 7




Source: Congressional Budget Office and Wells Fargo Economics

Part III: Figure 8




Source: Congressional Budget Office and Wells Fargo Economics

## Conclusion: Elections Have Consequences

Monetary policy often steals the spotlight from its fiscal policy sibling as markets hang onto every word from the nation's central bankers. Yet, the power to tax and spend has critical implications for both short- and long-run economic outcomes. The 2024 election will determine who is in charge come January 2025, and the incoming fiscal policymakers will face difficult decisions. Fiscal restraint in the form of higher taxes and/or lower spending can dent economic growth and the labor market in the near term, but a perpetual, yawning gap between revenues and outlays creates its own set of long-run economic problems.

The debt ceiling and annual budget process will undoubtedly create ripples in financial markets and in the economic outlook after the election. However, in our view, the most important fiscal policy topic in 2025 will be the debate over the looming expiration of the TCJA. We expect both parties to have interest in retaining parts of the law, but Republicans seem far more likely to maintain or even expand the landmark tax cut bill enacted under former president Donald Trump. Given this, and given that tax policy changes fit well within the rules of budget reconciliation, we think a Republican sweep of the White House and Congress is most likely to yield more fiscal stimulus, or at least no fiscal tightening.

A sweep by the Democrats could also lead to more fiscal policy accommodation, but we believe there are a couple of reasons this may be less likely. We suspect Democrats may be more interested in offsetting new policy initiatives with higher taxes, particularly for higher-earning households and corporations. In addition, some Democratic policy priorities may be harder to squeeze into the rigid budget reconciliation process. Divided government seems most likely to yield some marginal fiscal policy tightening, in our view. Regardless of who wins, serious long-run fiscal challenges are likely to remain amid an aging population, rising outlays on mandatory spending programs and rapidly growing debt service costs.

Election Day is still roughly eight months away, and it will be even longer before the fiscal policy decisions of the new president and Congress are felt in the U.S. economy. As we get closer to 2025, we will update and refine our analysis for the U.S. economic and fiscal policy outlook. Stay tuned.

## Endnotes

1 – Technically, the 2017 tax law is "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018." For brevity's sake, we refer to it by its colloquial name, the Tax Cuts and Jobs Act. (Return)

2 – The Joint Committee on Taxation. Estimated Budget Effects Of The Conference Agreement For H.R.1, The Tax Cuts And Jobs Act. *JCX-67-17*. December 18, 2017. (Return)

3 – Congressional Budget Office. Budgetary Outcomes Under Alternative Assumptions About Spending and Revenues. May 16, 2023. (Return)

4 – Penn Wharton Budget Model at the University of Pennsylvania. The Long-Term Budget Effects of Permanently Extending the 2017 Tax Cuts and Job Act's Expiring Provisions. April 11, 2023. (Return)

5 – For more detail on the fiscal drag on the economy around this time see Jane G. Gravelle. "The "Fiscal Cliff": Macroeconomic Consequences of Tax Increases and Spending Cuts." Congressional Research Service. January 9, 2013; and Parinitha Sastry and Louise Sheiner. "The Fiscal Headwinds Have Finally Subsided." The Hutchins Center on Fiscal and Monetary Policy at The Brookings Institution. November 3, 2014. (Return)

6 – See Table B-2. Congressional Budget Office. The Budget and Economic Outlook: 2018 to 2028. April 2018. (Return)

7 – Congressional Research Service. "The Economic Effects of the 2017 Tax Revision: Preliminary Observations." June 7, 2019; and Filippo Occhino. "The Macroeconomic Effects of the Tax Cuts and Jobs Act." Federal Reserve Bank of Cleveland. December 13, 2019. (Return)

8 – Congressional Budget Office. The Budget and Economic Outlook: 2024 to 2034. February 7, 2024. (Return)

9 – Stephanie Lai. "Trump Pledges to Slash Taxes If He Returns to the White House." Bloomberg. February 23, 2024. (Return)

10 – Christopher Condon. "Yellen Says Biden Would Seek Extension of Some Trump Tax Cuts." Bloomberg. January 25, 2024. (Return)

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