

## Tax Policy Outlook

The fiscal year ended last week, alarms went off both literally and figuratively, and a last-minute deal was reached to keep the government open for another forty-five days. Later in October the Treasury Department will figure out the final budget numbers for last year and we estimate the deficit will come in a little north of \$1.7 trillion, or 6.5% of GDP.

In a fiscal year when unemployment averaged only 3.6%, that's a horribly high budget deficit to run, and a sign that something is deeply wrong with US fiscal policy. Worse, this past year's deficit was artificially and temporarily held down by the Supreme Court striking down much of President Biden's plan to forgive student debt. Without that decision, the deficit would have been close to 8% of GDP.

The bottom line is that the US is approaching a fiscal reckoning sometime in the next few years where it will need to either reduce future spending or find more future revenue. Even tougher, this will have to happen in a geo-political backdrop where the US may have to ramp up military spending to project more power in the Pacific.

We root for spending cuts, particularly to entitlements. But, given that politicians who advocate for spending cuts using any tool they can find (debt ceiling or shutdowns) are verbally flayed by the establishment, we are not holding our breath. The establishment wants tax hikes, and that's likely what we will get.

The good news is that we don't think tax hikes will hit until at least 2026. Why that year? Because significant parts of the tax cuts enacted in 2017 under President Trump are set to expire at the very end of 2025. That expiration will focus the minds of politicians running for federal office in 2024, House, Senate, and

President. In turn, in 2025, depending on the outcome of the election, some sort of deal will be reached about extending those tax cuts.

We think there's about a 35% chance of a Republican sweep in 2024 (the presidency and majorities in both House and Senate). If that happens, we will likely get an extension of all the Trump tax cuts. However, unless that extension is coupled with aggressive spending cuts or entitlement reforms, it will be tough to sustain those tax cuts well beyond 2026.

We also think there is about a 20% chance of a Democratic sweep. If that happens, we're likely to get significant across-the-board tax hikes. Policymakers will claim they are only raising income tax rates on "the rich," but we think other kinds of tax hikes would be on the table, like higher gas taxes or maybe a carbon tax like the Clinton Administration proposed in 1993. In addition, taxes would likely go up on corporations, even though much of the burden from such a tax hike would be felt by their workers and their customers.

That leaves a 45% chance of having mixed government in 2025-26, with each party having control of at least one of the White House, the House or the Senate. In that case, expect most of the Trump tax cuts to be extended, except at upper income levels, where tax rates would likely revert to where they were under President Obama. This would be similar to the compromise that was reached for 2013, when the Bush tax cuts enacted in 2001 and 2003 were set to expire.

The one thing we know for sure is the US is on an unsustainable path. If we don't cut spending, tax hikes are eventually on the way.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
10-2 / 9:00 am	ISM Index – Sep	47.9	<b>47.7</b>	<b>49.0</b>	47.6
9:00 am	Construction Spending – Aug	+0.5%	<b>+0.5%</b>	<b>+0.5%</b>	+0.7%
10-3 / <i>afternoon</i>	Total Car/Truck Sales – Sep	15.4 Mil	<b>15.2 Mil</b>		15.0 Mil
<i>afternoon</i>	Domestic Car/Truck Sales – Sep	12.0 Mil	<b>12.0 Mil</b>		11.6 Mil
10-4 / 9:00 am	ISM Non Mfg Index – Sep	53.5	<b>53.8</b>		54.5
9:00 am	Factory Orders – Aug	+0.3%	<b>+0.6%</b>		-2.1%
10-5 / 7:30 am	Initial Claims – Sept 30	210K	<b>209K</b>		204K
7:30 am	Int'l Trade Balance – Aug	-\$59.7 Bil	<b>-\$58.1 Bil</b>		-\$65.0 Bil
10-6 / 7:30 am	Non-Farm Payrolls – Sep	168K	<b>160K</b>		187K
7:30 am	Private Payrolls – Sep	155K	<b>150K</b>		179K
7:30 am	Manufacturing Payrolls – Sep	5K	<b>5K</b>		16K
7:30 am	Unemployment Rate – Sep	3.7%	<b>3.7%</b>		3.8%
7:30 am	Average Hourly Earnings – Sep	+0.3%	<b>+0.3%</b>		+0.2%
7:30 am	Average Weekly Hours – Sep	34.4	<b>34.3</b>		34.4
2:00 pm	Consumer Credit – Aug	\$11.7 Bil	<b>\$11.7 Bil</b>		\$10.4 Bil