

December 19, 2024

WASHINGTON POLICY STRATEGY

Potomac Perspective

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In the wake of bipartisan criticism of a spending bill, House leaders are considering Plan B to fund the government into March. Although nothing is final, we think the odds of a government shutdown are low, but more importantly, this week's developments in Congress are just an appetizer for next year's main course on Capitol Hill. Investors should be prepared for a year that could lead to a few upset stomachs.

We will have a more detailed 2025 preview later, but the current week in Washington, D.C. could be a preview for next year. Developments suggest the chances of another protracted election for Speaker of the House are increasing. There are some warning signs about how rocky the road to a tax bill could be. Lastly, President-elect Donald Trump could pivot again and threaten Federal Reserve (Fed) Chairman Jerome Powell's job security.

The Budget Debacle

In the wake of a backlash against a government funding bill, Congress will have to switch to Plan B and pass a more streamlined version. The Continued Resolution (CR) that was released last night was not a true CR, which typically and simply extends current spending levels for a period of time. Instead, the CR included numerous extraneous items including increased spending levels, a process to vet China outbound investments, and a pay hike for Congress. The pay increase might have been the most politically damaging part of the bill. Even if it's justified, the optics of inserting it into a year-end bill were terrible. With President-elect Trump's stated opposition to the bill, Congress will have to pivot and pass a different bill.

Rewriting the CR will not be as easy as it might appear, because the bill included \$100 billion in disaster relief and \$10 billion for farmers. If those items are dropped from the bill or reduced, it could prompt some lawmakers to walk away. At this point, it is too soon to say whether the China outbound legislation and pharmacy benefit manager (PBM) reforms will be retained or dropped. We are relatively confident that the government will not shutdown, but the pathway towards getting a new CR has become much more tortuous.

House Speaker Mike Johnson's (R-Louisiana) future is also unclear. He helped craft the CR and is politically wounded due to its failure. The House will vote on January 3, 2025, to elect a Speaker for the next Congress, and we think Speaker Johnson's prospects have diminished. When the new House convenes, Republicans will hold a 219-215 majority (unless former Representative Matt Gaetz (Florida) pivots and decides to take his seat). A majority of those present and voting will be needed to elect a Speaker, so Johnson would need 218 votes. Representative Thomas Massie (R-Kentucky) has already said he will not vote for Johnson, thus the Speaker cannot lose any additional Republican votes. Given Republicans' current level of anger and frustration with Johnson, it is not difficult to envision another Republican voting against him on the House floor. We could be back to January and October 2023 when the House needed several ballots to elect a Speaker. We do not know who might succeed Johnson as Speaker if he fails to win enough support, but it would probably depend on who Mr. Trump chooses to back.

This is probably not how Republicans want their unified rule of Washington to start, but it could portend what to expect in 2025.

Warning Signs on Taxes

The circumstances associated with the CR and Speaker Johnson’s political future also illustrate the challenges Republicans will have in passing a tax bill in 2025. Representative Chip Roy (R-Texas) sent a warning shot when he said, “you are not getting tax cuts (next) year without corresponding, significant spending cuts that will reduce deficits.” The Congressional Budget Office has estimated that extending the expiring provisions of the Tax Cuts and Jobs Act of 2017 (JCTA) could add \$4.6 trillion on the debt over 10 years. That estimate does not include raising the cap on the State and Local Tax Deduction, Mr. Trump’s proposals to exempt income from taxes, overtime, and Social Security benefits from taxation, or Senator Josh Hawley’s (R-Missouri) proposal to increase the Child Tax Credit. Finding the offsets to which Representative Roy referred will be extraordinarily challenging and, as we noted above, Republicans have no room for error in the House. We think a tax bill will ultimately pass Congress, but it might not be a simple extension of the JCTA sunsets and could include some revenue raisers to keep down the bill’s price tag.

Possible Trump-Powell Pivot

Given the equity market selloff following yesterday’s Federal Open Market Committee announcement and Fed Chairman Powell’s press conference, we think there is a decent chance that President-elect Trump might pivot again and threaten to fire Mr. Powell. We reiterate that we do not believe a president can demote a Fed Chairman without cause. Even if Mr. Trump were to somehow succeed in forcing out Chair Powell, the Federal Reserve Act provides for a replacement. Under the law, the Vice Chairman (Philip Jefferson) would become Acting Chairman. In our view, Mr. Trump would not have the ability to elevate another Governor to the job. He might resort to using threats to fire Mr. Powell as a way to push Powell to lower interest rates, but we remain skeptical that Trump will follow through on these threats. Even if we are wrong and Trump tries to remove the Fed Chairman, we think the courts would side with Powell and the Fed.

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