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US Policy Pulse

A Big Beautiful Guide to the Big Beautiful Bill

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In this report, we dive into the various tax provisions in the recent tax reconciliation bill as well as the implications for debt, deficits and markets.

Key Insights:

- Passage of the GOP's top agenda item provides greater economic and policy certainty for investors, though tariffs remain an overhang as markets shift focus to trade and broader macroeconomic conditions.
- The primary provisions of the tax reconciliation bill include making the individual and corporate tax cuts from the TCJA permanent, introducing new individual and business tax cuts, reducing spending and increasing the debt limit by $5 trillion.
- The bill is estimated to add $3.3 trillion to the federal deficit over 10 years, potentially pushing it above 7% of GDP.
- Tax cuts are front-loaded, while spending cuts are back-loaded, positioning the greatest fiscal stimulus, equal to 0.8% of GDP, to occur in fiscal year 2026.
- Greater deficit spending could add upward pressure to term premiums and interest costs, potentially driving a higher-for-longer interest rate environment.
- Cuts to Medicaid funding could shift health care costs away from the federal government to localities, potentially pressuring the credit quality of certain state and nonprofit hospital municipal bonds.
- The revival of the various business tax provisions could boost growth and reduce the effective corporate tax rate to as low as 12%, from a statutory rate of 21%.
- A low tax environment may further incentivize capex, with domestic industrials, communications and energy stocks positioned to benefit.
- Clean energy stocks have outperformed the broader market this year by 13%, driven in part by softer-than-expected clean energy phaseouts.

Following the 2024 general election, Republican legislators were tasked with reforming the tax code to avert the sunsetting of many Tax Cuts and Jobs Act (TCJA) provisions at year-end 2025. In a previous report, we have noted that developing tax policy is multifaceted, often accompanied by fits and starts. The path to the final passage of the One Big Beautiful Bill Act (OBBBA) was no exception. Extension of the TCJA and the addition of new tax cuts, as well as the desire to reduce spending and limit deficit expansion, naturally created policy tension. However, intraparty conflict among GOP fiscal hawks focused on growing deficits,

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coastal-district Republicans prioritizing higher state and local tax (SALT) deductions, and legislators concerned with cuts to Medicaid benefits created an additional layer of negotiation complexity. With the final bill in hand, we examine some of the most significant implications for investors.

The OBBBA Blueprint

We break the bill's primary objectives and provisions into four parts: 1) reviving, expanding and making permanent certain individual and corporate tax cuts from 2017's TCJA; 2) introducing new individual and business tax cuts, including President Trump's "no-tax agenda" and full expensing of new factories; 3) reducing spending from cuts to Medicaid and the Supplemental Nutrition Assistance Program (SNAP) and phasing out certain clean energy tax credits while imposing excise taxes; 4) increasing the debt limit by $5 trillion.

Due to the intricacies of policymaking and lawmakers' various priorities, the final law includes a reconciliation of provisions derived from both the House of Representatives and the Senate. Key to gaining support from Republicans representing higher-tax states, the bill temporarily raises the SALT cap to $40,000 per household for modified adjusted gross incomes (MAGI) below $500,000 for four years. Other key provisions include President Trump's "no-tax" agenda and a $6,000 social security benefit for seniors, both of which sunset after four years. Previously expired and new business tax cuts, which are considered the most pro-growth elements of the bill, are revived permanently. These include 100% bonus depreciation for equipment investment; immediate deduction of domestic research and development (R&D) expenses and a looser limit on business interest expense deductibility; expansion of the Advanced Manufacturing Investment Tax Credit from 25% to 35% for semiconductors and semiconductor equipment; and full expensing of factories through 2028.

The bulk of deficit offsets comes from cuts to Medicaid and SNAP benefits as well as from repealing and phasing out the Inflation Reduction Act (IRA) tax credits. Importantly, Section 899, often referred to as the "revenge tax," was removed in the final version of the bill, while the excise tax on remittances was lowered from 3.5% to 1.0% and does not apply to debit and credit card transactions or to transfers originating from financial institutions subject to the Bank Secrecy Act. The bill also softens the excise tax on university endowments from a maximum of 21% to a maximum of 8% and retains the current law excise tax of 1.39% on private foundations.

Implications for Debt and Deficits

The impact of the budget, which is expected to increase both the primary deficit and government interest expenses, is especially important to consider in an elevated interest rate environment. The OBBBA increases spending by about $3.8 trillion over 10 years through 2034, offset by about $500 billion in revenues for a primary deficit impact of approximately $3.3 trillion. When considering the additional interest on the new borrowing, the total debt impact could be as high as $4 trillion over 10 years (see Exhibit 1).

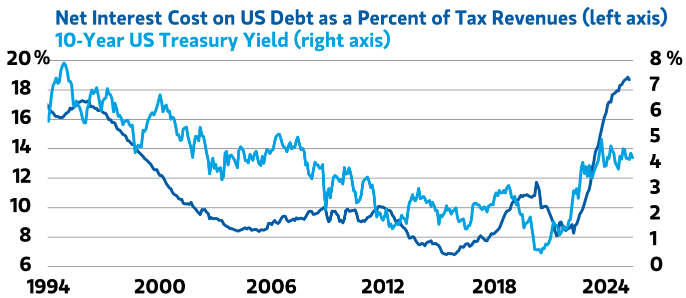
Exhibit 1: Major Provisions in Budget Reconciliation Bill

Tax Provision	10-Year Deficit Impact (billion)
Expand and Make Permanent TCJA Personal Provisions	
Extension of all other TCJA personal provisions	-$3,707
$40k SALT cap up to $500k income, increases 1% annually; reverts to $10k in 2030	-$145
Subtotal, Expand and Make Permanent TCJA Personal Provisions	**-$3,852**
Revive TCJA Business Provisions	
Permanently revive 100% bonus depreciation, immediate deduction of domestic R&D expensing, looser limit on business interest expense deductibility	-$565
Extend lower international rates	-$167
Extend and expand Opportunity Zones through 2033	-$41
Subtotal, Revive TCJA Business Provisions	**-$772**
New Individual and Business Tax Cuts	
No tax on tips, overtime, car loan interest; $6k senior std. deduction through 2028	-$246
Health savings account expansions	-$11
Establish $1,000 "TRUMP Accounts" and contribute through 2028	-$15
Full expensing of new factories through 2028; Advanced Manufacturing Investment Tax Credit for semis and semis equipment to 35%, from 25%	-$156
Other individual and business-related tax cuts	-$274
Rural hospital relief fund	-$47
Subtotal, New Individual and Business Tax Cuts	**-$749**
Offsets and Revenue Raisers	
Repeal EV tax credits; repeal, reform, phase out certain IRA credits	$543
Excise tax, such as on remittances, college endowments, etc.	$164
Health care changes including Medicaid, SNAP, ACA, FMAP	$1,121
Subtotal, Offsets and Revenue Raisers	**$1,828**
Subtotal	**-$3,545**
Provisions for Immigration, border, defense, agriculture, transportation, energy, etc.	$180
Primary Deficit Impact	**-$3,365**
Interest	-$713
Total debt impact with interest	**-$4,078**

Note: For a complete list of all provisions and their cost estimates, please refer to the Committee for a Responsible Federal Budget or the Congressional Budget Office.
Source: Committee for a Responsible Federal Budget, Joint Committee on Taxation, US Senate, Morgan Stanley Wealth Management Global Investment Office as of July 2, 2025

Breaking down the bill's deficit sequencing over the 10-year budget window, we find that tax cuts are front-loaded and spending cuts back-loaded, with the greatest fiscal expansion estimated to occur in fiscal year 2026. Importantly, the estimates we cite assume the use of "current law" accounting, which counts the costs associated with new and extended tax policies. When using the "current policy" convention, which assumes no new costs from the extension of existing tax policy, notable deficit growth still occurs, underscoring the nation's long-term structural budget imbalance. Furthermore, the latest deficit expansion comes at a time when federal debt stands at $36 trillion (approximately 123% of US GDP) and additional spending is projected to push the deficit-to-GDP ratio north of 7% by 2026—double the pre-Great Financial Crisis historical average of 3%. In addition, one in five federal tax dollars is directed to interest payments alone (see Exhibit 2).

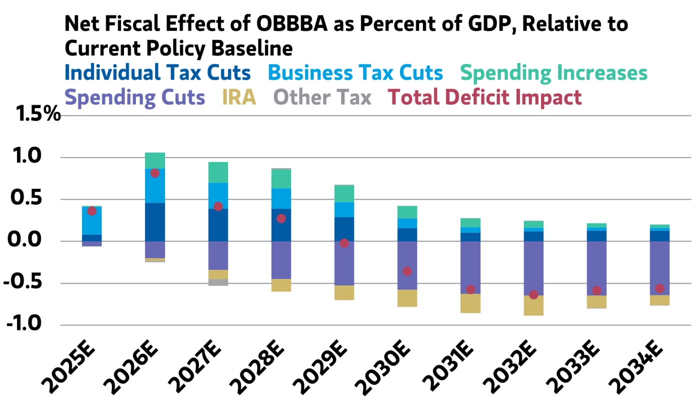
Exhibit 2: One in Five Federal Tax Dollars Go to Paying Interest



Source: Strategas, Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of July 8, 2025

Deficit spending often serves as a method to stimulate the economy. Considering the bill's economic impact on a current policy basis, the bill could add 0.4% to GDP in fiscal year 2025, peaking in fiscal year 2026 at 0.8% of GDP. By the early 2030s, some individual tax cuts, such as no tax on tips, overtime pay and car loan interest, will have expired, while spending cuts and IRA phaseouts will have kicked in, reducing the deficit as a percent of GDP relative to current policy (see Exhibit 3).

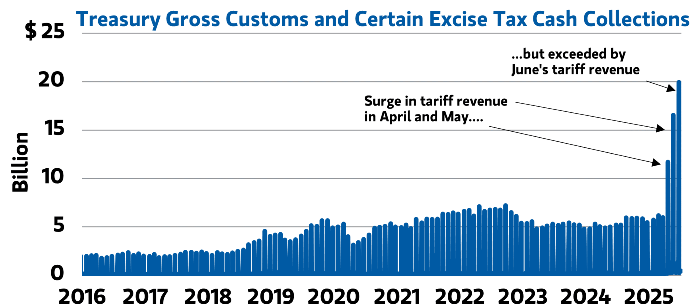
Exhibit 3: Deficit Impact Peaks in Fiscal Year 2026 as Tax Cuts Are Front-Loaded and Offsets Back-Loaded



Source: Piper Sandler and Co., Morgan Stanley Wealth Management Global Investment Office as of July 8, 2025

Given these budgetary constraints, the Trump administration has highlighted potential tariff revenues, which are not included in the budget process, as a partial offset to budget pressures. The administration has prioritized the use of tariffs for many reasons, one of which is their revenue-raising abilities. Since the onset of Trump's reciprocal tariffs and the 10% universal tariff regime in April, tariff revenues have surged to all-time high levels. Industry-specific tariffs on autos, steel and aluminum have also been in effect. The monthly tariff revenue has averaged $22.3 billion, up from about $5 billion over the past five years. If this trend were to continue over the long term, it would imply a potential $2.7 trillion in revenues, which could serve as a notable offset to current deficit expansion (see Exhibit 4).

Exhibit 4: Extrapolating the Past Three Months' Tariff Revenues Would Imply Potential for $2.7 Trillion of Revenues Over 10 Years



Source: Daily Treasury Statement, Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of July 9, 2025

That said, trade negotiations and deals are ongoing, dynamic and difficult for investors and market participants to predict or rely on, especially on a 10-year horizon. For example, trade volumes could reroute, and supply and demand dynamics could shift if tariffs are too high, with the potential for much lower revenue than current projections. Regardless of potential revenue offsets, the ballooning US deficit will need to be factored into future budgetary decisions, as tighter fiscal policy parameters limit legislators' ability to respond to economic events and crowd out other spending priorities.

OBBBA and Fixed Income Markets

When considering the impact of the bill on fixed income markets, we highlight a number of important factors for investors. First, the $5 trillion debt limit increase will require the Treasury General Account (TGA) to be refilled after months of low Treasury bill issuance, likely with a significant increase in net Treasury bill issuance. The issuance of new debt to cover the recent deficit expansion could support a supply and demand mismatch in the US Treasury market, which could add upward pressure to the 10-year US Treasury term premium—the amount of compensation in the form of yield required by investors to take on related risk. In other words, Fed balance sheet growth from 2020 to 2022 had held down term premiums, but its balance sheet unwind since mid-2022 meant that Treasury supply had to be absorbed by other buyers, un-anchoring term premiums. Importantly, the effect of the supply increase is as critical as the demand side of the equation, signified by foreign holdings of US Treasuries as a percent of total US debt. While foreign demand has modestly increased for the year to date, it remains range-bound and is unlikely to offset expectations for notable debt issuance (see Exhibits 5a and 5b). Relatively stable investor demand likely indicates that higher US Treasury yields are not primarily attributable to an investor flight from US Treasuries. Should foreign holdings of US Treasuries meaningfully decline, the term premium may experience further upward pressure.

Exhibit 5a: Federal Reserve Balance Sheet Unwind Put Upward Pressure on Term Premium

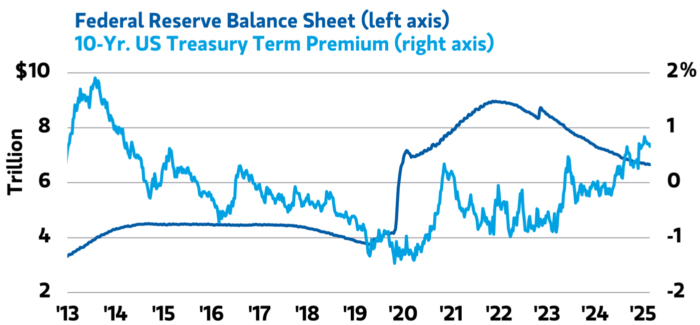
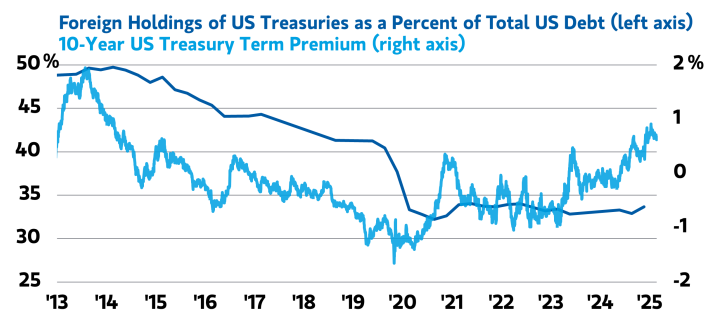


Exhibit 5b: Foreign Investor Participation Has Been Stable, Yet the Term Premium Has Risen



Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of July 8, 2025

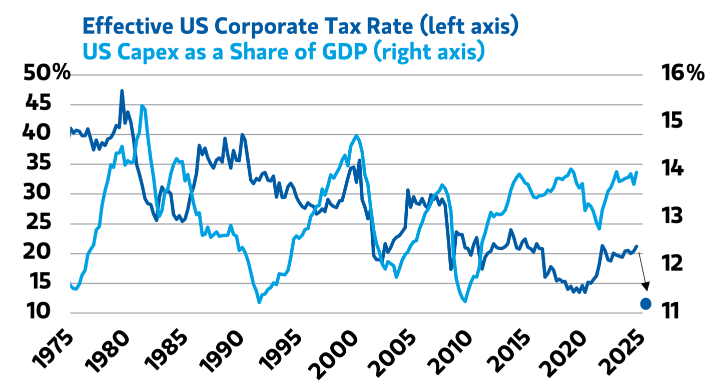
The Morgan Stanley Wealth Management Global Investment Office fixed income team also notes that while some investors may not have expected the legislation's specific mix of tax and spending cuts, the all-in net deficit impact and extension of TCJA provisions were not surprising. As such, elevated term premiums could already be reflecting these factors.

Turning away from deficit expansion and toward the bill's spending reductions, cuts to Medicaid are front and center. The OBBBA reduces Medicaid spending by approximately $900 billion, accounting for more than half of the legislation's total cost savings. The Congressional Budget Office estimates that these health care changes could reduce the number of people with health insurance by 17 million by 2034. Reductions to Medicaid funding may also shift health care costs from the federal government to state and local governments. State and local governments could be burdened by the increased health care costs. Furthermore, Medicaid cuts are also likely to result in notable revenue losses for hospitals, despite the inclusion of a $47 billion rural hospital relief fund, pressuring the credit quality of certain state and nonprofit hospital municipal bonds.

Equity Markets and Industry Impacts

Reaffirmation of the TCJA's business tax framework and introduction of new corporate tax provisions are likely to provide the greatest benefit to corporate stakeholders. While the average statutory corporate income tax rate remains at 21%, reinstatement of the TCJA's business provisions—such as 100% bonus depreciation, immediate deduction of domestic R&D and interest expense deductibility, as well as new provisions like expanding the Advanced Manufacturing Investment Tax Credit and full expensing of factories—could push the effective corporate rate to as low as 12%, the lowest level in US history (see Exhibit 6). While US capex as a share of GDP has increased significantly since 2020, driven partially by the development of AI and related energy needs, it could grow further. A reduced tax burden may support capex tailwinds in advanced technology sectors such as semiconductors, semiconductor equipment and AI data centers, and could favor industrials, communication services and energy stocks with elevated capex needs and revenue derived in the US.

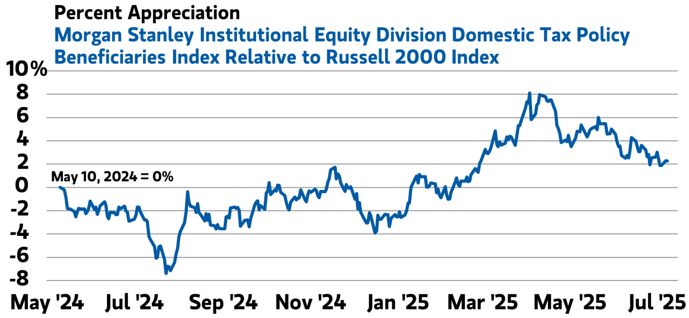
Exhibit 6: Business Tax Provisions Could Push Down the Effective US Corporate Tax Rate



Source: Piper Sandler and Co., Morgan Stanley Wealth Management Global Investment Office as of March 31, 2025

Recent market action supports this thesis, as the Morgan Stanley Institutional Equity Division Domestic Tax Policy Beneficiaries Index has outperformed the Russell 2000 Index by about 2% over the past year (see Exhibit 7). The index is composed of stocks positively exposed to domestic tax changes this year, as well as stocks with elevated capex and revenue in the US. It mainly includes industrials stocks but also includes communications services, energy and materials, among other sectors.

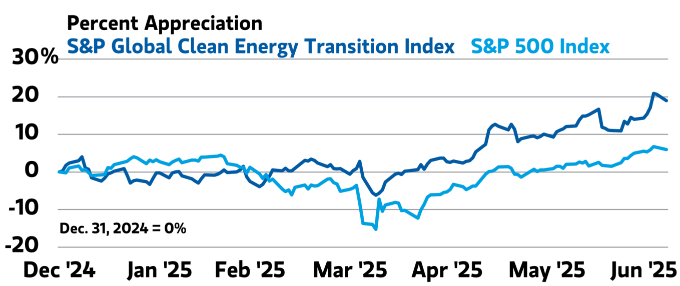
Exhibit 7: Investors Are Rewarding Stocks With Favorable Exposure to Pro-Growth Tax Changes



Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of July 8, 2025

The bill immediately phases out some of the IRA's clean energy tax credits, including those for electric vehicles, home solar and storage, while utility-scale wind and solar power projects, for example, face softer phaseouts that include a one-year safe harbor and a "placed in service" deadline of Dec. 31, 2027. Relative to expectations entering 2025, the final iteration of the bill can be viewed as softer on clean energy than initially anticipated, especially in regard to hydrogen, geothermal and nuclear energy production. In fact, clean energy stocks have outperformed the S&P 500 Index by more than 13% this year, driven by upside policy surprises and anticipation of Fed rate cuts in the next 12 months (see Exhibit 8).

Exhibit 8: Clean Energy Stocks Have Outperformed the S&P 500 This Year



Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of July 8, 2025

Investment Conclusion

Congressional Republicans satisfied numerous campaign promises through the passage of the OBBBA. However, the bill is likely to materially add to the federal deficit and may continue to drive a higher-for-longer interest rate environment. Tariffs could serve as a revenue offset to the broader budgetary imbalance, though the tariff outlook is highly uncertain.

The OBBBA likely favors US-focused, domestic tax beneficiaries in certain parts of the industrials, communication services and energy sectors, with tailwinds from the various corporate tax provisions that could lower the effective tax rate to historic levels. Clean energy stocks, meanwhile, continue to outperform the broader market this year despite policy headwinds. Cuts to Medicaid funding, however, could shift health care costs away from the federal government to local governments, potentially pressuring the credit quality of certain state and nonprofit hospital municipal bonds.

Disclosure Section

For index, indicator and survey definitions referenced in this report please visit the following:
https://www.morganstanley.com/wealth-investmentsolutions/wmir-definitions

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Artificial Intelligence (AI) A field of study that seeks to train computers to process large amounts of unstructured information in a manner similar to human intelligence, capable of performing tasks such as learning and problem solving.

Nominal Gross Domestic Product (GDP) is the GDP of the country measured at current market prices and not adjusted for inflation or deflation.

Real Gross Domestic Product (GDP) is the GDP of the country measured at current market prices and adjusted for inflation or deflation.

Risk Considerations

Investing in foreign markets entails greater risks than those normally associated with domestic markets, such as political, currency, economic and market risks. **Investing in currency** involves additional special risks such as credit, interest rate fluctuations, derivative investment risk, and domestic and foreign inflation rates, which can be volatile and may be less liquid than other securities and more sensitive to the effect of varied economic conditions. In addition, international investing entails greater risk, as well as greater potential rewards compared to U.S. investing. These risks include political and economic uncertainties of foreign countries as well as the risk of currency fluctuations. These risks are magnified in countries with **emerging markets and frontier markets**, since these countries may have relatively unstable governments and less established markets and economies.

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