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WEALTH MANAGEMENT

INVESTMENT STRATEGY

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US Policy Pulse

10 Policy Actions To Watch in 2025

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In this report, we will discuss some of the top policy actions that could occur under the incoming administration and their potential impact on the markets and the economy.

Key Insights:

1. Budget cuts and DOGE could be hindered by structural barriers.
2. Most individual tax provisions will likely be extended.
3. Corporate tax cuts may be restrained.
4. The debt ceiling deadline could stall the Republican policy agenda.
5. Tariffs are likely to add to idiosyncratic risk.
6. Deregulation could have mixed outcomes for equity sector performance.
7. Clean energy is positioned to outperform traditional energy.
8. Health care risks may be priced in; pharma and managed care may experience regulatory pressure.
9. Restrictive immigration policies could have longer-term economic impacts.
10. Evolving geopolitical risks could drive bifurcation of defense sector performance.

A new year often serves as a catalyst for individuals to review past actions, reconsider long-term goals and pivot toward new pursuits. The 2025 political regime change, ushering in a GOP-controlled White House and Congress, sets the stage for a similar wholesale reassessment of past government action and the opportunity to set course on a new path for policymaking. While the full menu of potential policy actions and their respective details remain unknown, President-elect Trump has strongly signaled his desire for lower taxes, federal budget cuts and greater deregulation. Congress and the administration will be tasked with achieving these goals while maintaining balance between monetary and fiscal policy, as well as economic and market performance. We have long stated that the full economic and market impact of Trump's agenda depends on the magnitude, scope and depth of the enacted policies, as well as on their timing and sequencing. As such, market participants may face a patchwork of conflicting policy goals, that, together, may elevate policy uncertainty. For example, while many of President-elect Trump's campaign proposals are pro-growth, promoting higher nominal growth and/or pressuring cost levels could fan inflation and spur hawkish monetary policy. However, a lag in policy implementation and more modest legislation than expected could prompt the Federal Reserve to take a less restrictive approach.

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While the Republican sweep could deliver some initial policy realignment, we expect intraparty disagreements to slow the pace at which campaign trail promises are actualized, such as those regarding broad tax cuts and swift budget negotiations. Tariff, immigration and deregulation policy impacting sectors such as health care, banks and energy add greater policy uncertainty in 2025—all while geopolitical tensions and foreign policy activity escalate. In this report, we discuss the top public policy and regulatory actions that we expect to impact markets and the economy in 2025.

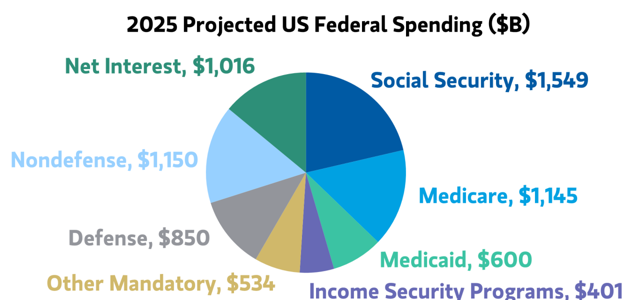
1. Budget Cuts and DOGE Could Be Hindered by Structural Barriers

We expect the federal budget to be a dominant discussion point this year, with the thin margins of Republican control in both the House of Representatives and the Senate likely to cause budget negotiations to be more fragile than investors anticipate. While the Trump White House is likely to focus on baseline budget cuts and constructing a leaner, more efficient government, the GOP's five-seat lead in the House is likely to expose the ideological differences between the pro-tax-cut and deficit-hawk legislators. As tax and spend priorities are concretized, tensions are likely to emerge between GOP spending priorities, structural and legal hurdles preventing proposed spending cuts, and their debt and deficit impact.

For example, the newly formed Department of Government Efficiency (DOGE), which is an advisory committee and not a formal government entity, has targeted $2 trillion of federal government cost savings. While the committee's leaders are armed with a loud microphone, we caution investors, as we expect DOGE to face considerable constraints in achieving its goals. First, DOGE is solely an advisory entity, with Congress maintaining the ultimate power to cut spending. As a result, its guidance and ideas may or may not be implemented by Congress, as the power of the bully pulpit is limited once legislators are called to make hard choices. Second, mandatory spending makes up 60% of US government spending, including Social Security, Medicare and Medicaid, and is unlikely to experience meaningful reductions given its political sensitivity (see Exhibit 1).

Exhibit 1: DOGE Faces Budget Constraints

2025 Projected US Federal Spending ($B)



Source: Congressional Budget Office (CBO), Morgan Stanley Wealth Management Global Investment Office as of Jan. 6, 2025

The remaining 40% of federal outlays includes 10% directed toward defense, which is unlikely to be cut given sustained geopolitical tensions driving national security concerns. Half of the remaining 30% of the federal budget is used for debt payments, leaving another 15%, or approximately $1.15 trillion, for other government and executive branch operations, such as the Departments of Energy, Transportation, Veterans Affairs, Health and Human Services, Homeland Security and more. While savings could be achieved, the chances of cuts having a meaningful fiscal impact are low.

2. Most Individual Tax Provisions Will Likely Be Extended

Key provisions in the Tax Cuts and Jobs Act (TCJA), set to expire at the end of 2025, will have consequences mostly for individual investors, making tax policy a central element to the Trump agenda this year within the context of fiscal sustainability. Without congressional action, the expiring individual TCJA provisions, which would increase taxes by $400 billion, would include those pertaining to the individual income tax rate, standard deduction, personal exemption, child tax credit, alternative minimum tax (AMT), state and local tax (SALT) deduction and estate/gift taxes, among others.

That said, a unified Congress is likely to extend most of the expiring provisions that are pivotal aspects of Trump's landmark tax legislation, such as those pertaining to individual income tax rates and estate/gift tax exemptions. However, the thin majorities in the House and Senate could compel lawmakers to potentially incorporate other tax breaks, like a marginal increase to, or elimination of, the $10,000 SALT cap, which could encourage support from lawmakers living in high-tax states. Notably, the TCJA-imposed SALT cap was introduced as a revenue offset for the bill's deep cuts, but Trump's recent campaign trail endorsement of lifting or removing the cap, indicates it could be adjusted in 2025. Other campaign trail proposals, such as no tax on tips or overtime, could be honored by Congress as a time-limited tax holiday.

3. Corporate Tax Cuts May Be Restrained

TCJA replaced the graduated corporate income tax rate, which peaked at 35%, with a 21% flat tax enacted on a permanent basis. Though Trump has proposed further reductions to as low as 15%, we caution investors, as post-election market exuberance has partly hinged on expectations for deeper corporate tax cuts. Importantly, fiscal concerns and the need for revenue offsets may drive lawmakers to hold the 21% corporate tax rate steady. Unchanged corporate income taxes or the consideration of other corporate tax increases to offset deficit spending could disappoint financial markets.

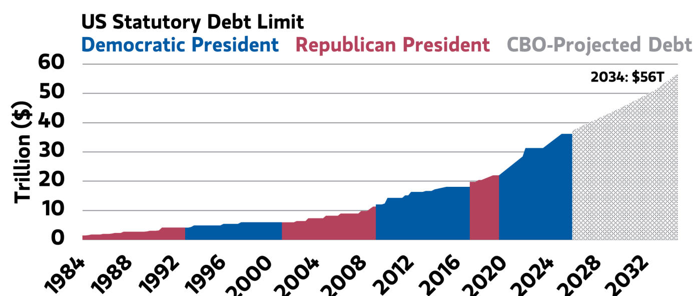
We emphasize that if Congress considers tax increases, they are likely to be limited and could impact companies that do business abroad or receive notable overseas revenues. For

example, legislators could preemptively increase the global intangible low-taxed income (GILTI), which is already scheduled to rise from 10% to approximately 13% in 2026. GILTI was created in 2017 to tax US multinational companies operating abroad to incentivize the reshoring of US businesses.

4. The Debt Ceiling Deadline Could Stall the Republican Policy Agenda

On Jan. 2, the US government reached the federal debt limit of $36 trillion, which is projected by the Congressional Budget Office to grow to $56 trillion by 2034E (see Exhibit 2). The US Treasury Department invoked the use of extraordinary measures to continue to meet all current obligations, which include, but are not limited to, suspensions and delays of some debt sales, reinvestment and auctions. While the debt ceiling has not caused the federal government to default on its debt, it has fostered significant tension when the government has moved dangerously close to the limit, and it has pressured the Treasury's ability to pay for baseline government operations and conduct necessary borrowing. Since 2002, the statutory debt limit has been lifted or suspended more than 20 times.

Exhibit 2: Both Parties Are Responsible for US Debt Accumulation



Source: Congressional Budget Office (CBO), Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of Jan. 6, 2025

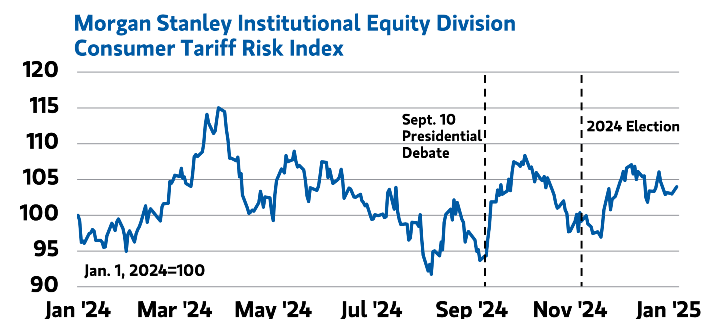
Debt limit episodes tend to be resolved more gracefully amid unified-government scenarios, but unified partisan control doesn't guarantee swift resolution. That said, while we do not expect the US to default on its debt, we highlight that upcoming debt negotiations may be entangled with fiscal policy concerns over growing debt and deficits, ultimately slowing the pace of policymaking in 2025. Recognizing the debt ceiling episode's capacity to delay his agenda, President-elect Trump unsuccessfully advocated for debt ceiling resolution prior to taking office. We expect Congress to either raise or suspend the debt ceiling this summer as extraordinary measures and the Treasury General Account cash balance are likely to sustain baseline operations until then.

5. Tariffs Are Likely To Add to Idiosyncratic Risk

Trade policy, along with the related use of tariffs, is among the top policy areas that we believe are most sensitive to the election. Trump has put forth plans for an aggressive tariff regime, including raising tariffs to 60% on Chinese goods, the introduction of a universal tariff that could range from 10% to 20% and a 25% tariff on Canadian and Mexican goods. While he has touted the use of tariffs as a key policy to support the US economy and as a negotiating tool in foreign relations, such an aggressive tariff regime is likely to increase US inflation and negatively impact productivity. In an assessment of his plans, we found that an increase of tariffs to 60% on China and a 10% universal tariff would add 1.6% to inflation and reduce GDP by 0.3% in the first year of enactment.

Furthermore, market performance of industries and sectors particularly exposed to tariff risk has been sensitive to political rhetoric. For example, the Morgan Stanley Institutional Equity Division Consumer Tariff Risk Index rebounded after the Sept. 10 presidential debate. The basket's 9% rally from the predebate low could be attributed to Harris' strong performance and investor preference for a status quo tariff regime. However, immediately after Trump's second presidential win, the index sold off 3.3%. More recently, performance has been choppy, as the press and the Trump transition team have sent mixed messages regarding the president-elect's tariff strategy. The index includes companies with high exposure to offshore production costs and elevated revenues from the US, which could react negatively to a tariff increase (see Exhibit 3).

Exhibit 3: Tariff-Exposed Stocks May Be Sensitive to Trade Policy Announcements



Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of Jan. 5, 2025

6. Deregulation Could Have Mixed Outcomes for Equity Sector Performance

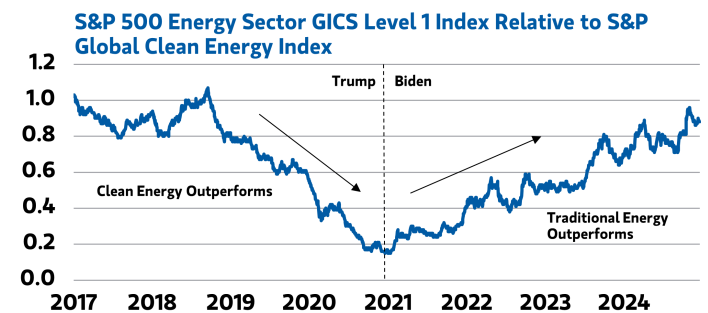
Greater deregulation serves as a key component of Trump's pro-economic growth proposals. The president-elect aims to lower regulatory barriers and lessen federal agency oversight through budget cuts, rollbacks of Biden-era executive orders and reduction of bureaucratic processes. That said, the broad application of regulatory easing could have notable positive and negative impacts across numerous industries. These include, but are not limited to, health care, financial services, cryptocurrencies, the broader tech sector and artificial intelligence (AI). For example, anti-vaccine mandates, accompanied by more-stringent FDA approval processes, could weigh on pharmaceutical company performance, while looser oversight of financials could result in greater adoption of risk-weighted assets and create tailwinds for large-cap banks. Less federal scrutiny is also likely to provide a more favorable environment for cryptocurrency and blockchain technology. On the tech front, the federal government is likely to promote greater AI adoption, while also calling for less-stringent content and posting guidelines on traditional social media platforms.

Mergers and acquisitions (M&A) are expected to benefit from the deregulation playbook. Morgan Stanley & Co. Research analysts anticipate a cyclical and structural rebound in M&A, consistent with an approximately 50% pickup in 2025. We expect this to be further supported by changes to the Federal Trade Commission's leadership, resulting in less scrutiny for M&A deals over the next four years.

7. Clean Energy Is Positioned To Outperform Traditional Energy

We expect clean energy to outperform traditional energy in 2025, despite the Trump administration's promise to dismantle climate change-focused policies. While the administration's priorities are likely to present headwinds for the industry, we expect market dynamics to play a constructive role for clean energy. In addition, policies incentivizing increased oil drilling could drive downward pricing pressure for traditional energy, especially given an elevated supply backdrop. That said, clean energy outperformed during Trump's first term, when interest rates were lower, while traditional energy outperformed during Biden's term, when rates were higher and geopolitical risks were elevated, indicating that the macroeconomic and geopolitical environments tend to drive energy performance. These dynamics challenge the assumption that Trump is a positive for traditional energy over clean energy, as clean energy companies are rate sensitive (see Exhibit 4). The sensitivity to interest rates may be attributed, in part, to many clean energy companies' behaving like growth stocks, which typically rally when rates decline, as easy lending conditions provide opportunities for greater research and development (R&D) and capital expenditure investment. We currently expect two 25-basis-point rate cuts by the end of 2025, which could provide more constructive technical dynamics in the coming year.

Exhibit 4: Clean Energy Outperformed Under Trump, but Traditional Energy Has Outperformed Under Biden



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

Furthermore, we expect major attempts to unravel or reverse the Inflation Reduction Act's clean energy provisions to be politically unfavorable, despite conflicting GOP messaging. This is because approximately 80% of the funds allocated for clean-energy initiatives have benefited Republican-controlled states and districts, which we think will temper eventual policy changes toward the Inflation Reduction Act.

8. Health Care Risks May Be Priced In; Pharma and Managed Care May Experience Regulatory Pressures

Health care is likely to be a focal point for the incoming administration, with pharmaceuticals, managed care beneficiaries and other insurance companies negatively impacted due to the potential for less-stringent vaccine mandates, as well as for further weakening of the Affordable Care Act (ACA) and related subsidies. Reductions in vaccine mandates, accompanied by greater scrutiny of pharmaceutical development and a stricter approval process from the Food and Drug Administration (FDA), could drag on pharma market performance. That said, Trump's prior willingness to expedite approvals for COVID-19 vaccines could create a conflict within the administration, as the desire to respond with greater efficiency to a health crisis may override anti-mandate trends and changes to FDA policies.

In addition, managed care and ACA beneficiaries are likely to be impacted, as the prior Trump administration decreased funding for outreach and education programs for ACA marketplace plans and Medicaid by 84%. While the Biden administration revived these programs and extended funding through 2029, the GOP is likely to seek other means to reduce costs associated with the ACA and Medicaid plans. Furthermore, Congress is likely to allow enhanced ACA subsidies to expire at the end of 2025. Without Congress acting to extend the subsidies, Kaiser Family Foundation

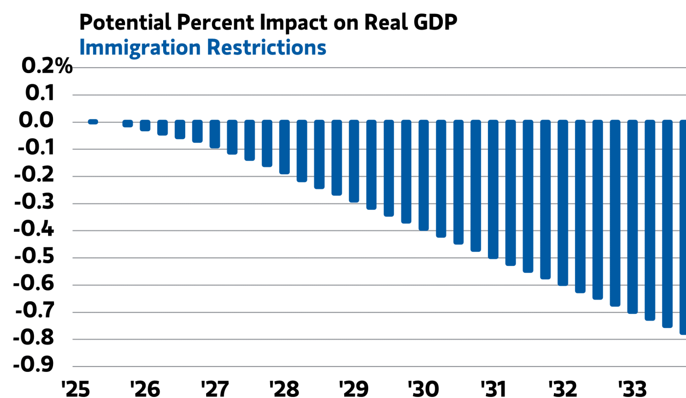
estimates that net premium payments could rise, on average, by 79% and more than double in some states.

9. Restrictive Immigration Policies Could Have Longer-Term Economic Impacts

Changes to immigration policy and securing the border are among Trump's day-one priorities. Restrictive immigration policies would include, but not be limited to, more aggressive deportation plans, expansion of the border wall, increased funding for the Department of Homeland Security, elimination of programs like the Deferred Action for Childhood Arrivals (DACA) and reevaluation of visa and asylum seeker programs. These potential actions could start to have a material impact on immigration flows starting in mid-2025, primarily driven by lower refugee admissions and the reinstatement of the Migrant Protection Protocols, also known as the "remain in Mexico" policy. This program required asylum seekers to remain in Mexico until they received authorization to work. According to Oxford Economics, the remain in Mexico policy alone could cause net migration to fall from 1.1 million people annually to around 800,000.

When accounting for this more limited restriction scenario, it is projected that GDP could fall by 0.4% in the first five years (see Exhibit 5). Importantly, this does not account for the long-run impacts of tighter immigration policies, which place an exponential drag on productivity over time as demographic changes take hold and fertility and birth rates decline. We expect the second Trump administration to take a hawkish approach in its initial days, with actual deportation numbers exceeding the Oxford Economics estimates. Should significant deportations and closed border policies be enacted, it could more notably pressure productivity.

Exhibit 5: Immigration Restrictions Could Impact Growth Over the Long Term



Source: Oxford Economics; Morgan Stanley Wealth Management Global Investment Office as of Jan. 6, 2025

10. Evolving Geopolitical Risks Could Drive Bifurcation of Defense Sector Performance

Throughout the 2024 election, we noted that defense sector performance tracked the odds of a Democratic presidential win, challenging the longstanding assumption that Republican administrations are more favorable for defense. With a GOP sweep, US policy toward various security challenges—such as Ukraine and NATO involvement—remains somewhat unclear, driving uncertainty in the sector. That said, US defense spending should remain in the historical 1%-3% growth range.

Technologically, shifting methods of warfare also demand greater adaptation of and investment in alternative and advanced defense technology companies, beyond the big players. Emerging emphasis on less traditional defense areas could benefit companies providing capabilities related to cybersecurity, space, artificial intelligence, drones, satellites and advanced radar detection. Furthermore, upstream support necessary for building out the US defense industrial base is critical; as such, areas including infrastructure, nuclear as a source of energy and semiconductors could also outperform.

Disclosure Section

Index Definitions

For index, indicator and survey definitions referenced in this report please visit the following:

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