KPMG Economics

Policy shifts & the economy
Inflation & higher interest rates

Diane C. Swonk, Chief Economist
KPMG US
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The Republican sweep of the White House and Congress has altered the economic outlook. Our baseline preelection only included an extension of personal tax cuts in 2026. No other policy shifts were assumed, given the uncertainty surrounding the outcome of the election. We are now phasing in new policies of the incoming administration into our baseline forecast.

The largest issues for voters were inflation and immigration. The US is not unique on that front. Inflation was a global phenomenon post-pandemic as was the backlash to immigration.

Voters do not delineate between global and domestic causes when assigning blame for their pain. A record number of elections were held in 2024; a record number of incumbents lost power. The vice president and the Democratic Party are included in that mix.

Making laws and appropriating funds takes time. The gap between what a candidate promises on the campaign trail and what can be achieved postelection can be large. The question is how large.

The clock is ticking on a federal budget. Congress opted to punt on a new budget before the election and enacted a continuing resolution that expires December 20. That keeps the government open at existing spending levels but needs to be extended into 2025 to avoid a shutdown.

The current suspension of the debt ceiling will expire on January 2, 2025. That means the lame duck Congress needs to lift or suspend the debt ceiling again to avoid a default in early 2025.

Further complicating matters are structural shifts postelection. Escalating geopolitical tensions, increased protectionism, supply chain problems, a surge in extreme weather events and mounting government debt have made the economy more inflation-prone than pre-pandemic.

Consumers power through

Real GDP grew at a 2.8% annualized rate in the third quarter, close to the 3.0% pace of the second quarter. Consumer spending gained momentum as discounting picked up. Home buying and building contracted for the second consecutive quarter in response to high mortgage rates, shortages and low affordability. Business investment slowed, with a jump in equipment spending only partially offsetting a drop in commercial construction. Inventories drained. Government spending accelerated; defense spending surged at a double-digit pace. The trade deficit widened as an acceleration in imports swamped a rise in exports.

Prospects for the fourth quarter are not as good, with growth forecast to rise a subdued 1.5%. Consumer spending is expected to slow but not collapse, with a slowdown in employment. Home buying and building is expected to tread water. Business investment is poised to lose ground, with a strike delaying aircraft deliveries and suppressing equipment spending. Inventories hold steady, with efforts to hedge a jump in tariffs offsetting the drag from strikes and storms. Government spending slows in response to a continuing resolution, which holds much of spending at fiscal 2024 levels. Spending by state and local governments is expected to decelerate in response to a shortfall in tax revenues in fiscal 2024. The trade deficit remains a drag on growth, as producers and retailers scramble to get imports in ahead of tariffs.

Fed slows pace of cuts. The Fed is still expected to cut once more in December, although support for another cut this year within the Fed is waning. Powell made clear that the Fed intends to slow the pace of cuts going forward. We still have another percent of cuts in 2025, but the Fed now stops short of its estimates of neutral in 2026. The fed funds target ends the current rate-cutting cycle in the 3.25-3.5% range, a half percent higher than last month.

Risks. Financial markets have decoupled, with bond investors pricing in a greater threat of inflation than stock investors. Inflation and interest rates could be much higher than forecast; growth in 2026 could be much weaker than forecast.

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The embers of inflation are still cooling. Policies that tend to stoke inflation will act more as an accelerant post-pandemic than pre-pandemic, when the president-elect last held office.

Bond investors have already digested that news. Bond yields rose before the election, as estimates of deficits under both candidates ballooned. They moved higher after the election, reflecting forecasts for larger deficits and higher inflation under the president-elect.

This edition of *Economic Compass* takes a closer look at what the new president and Congress are likely to prioritize. It seems an easy bet that shifts to trade policy, curbs on immigration, fiscal stimulus and an easing of regulatory burdens will take center stage.

What is less clear is how to pay for those changes without triggering a new round of inflation. A failure to do so could raise the ire of the bond market. Beware the return of the bond vigilantes.

Changes postelection

A benign scenario

Chart 1 compares the forecast pre- and postelection. We have assumed a scaled-back suite of tariffs, tax cuts and curbs to immigration as a starting point:

- Unemployment is slightly lower in 2025 but rises in 2026, as the economy stalls.
- The economy is now forecast to grow in 2025 but weaken in 2026. The boost to growth by fiscal stimulus is more than offset by the constraints due to tariffs and curbs on immigration.
- Inflation reignites in 2026 and moves up more rapidly in out-years.
- The Federal Reserve abandons rate cuts in 2026, if not sooner. The fed funds rate ends 2026 in the 3.25%-3.5% range, a half percent higher than we had just a month ago.

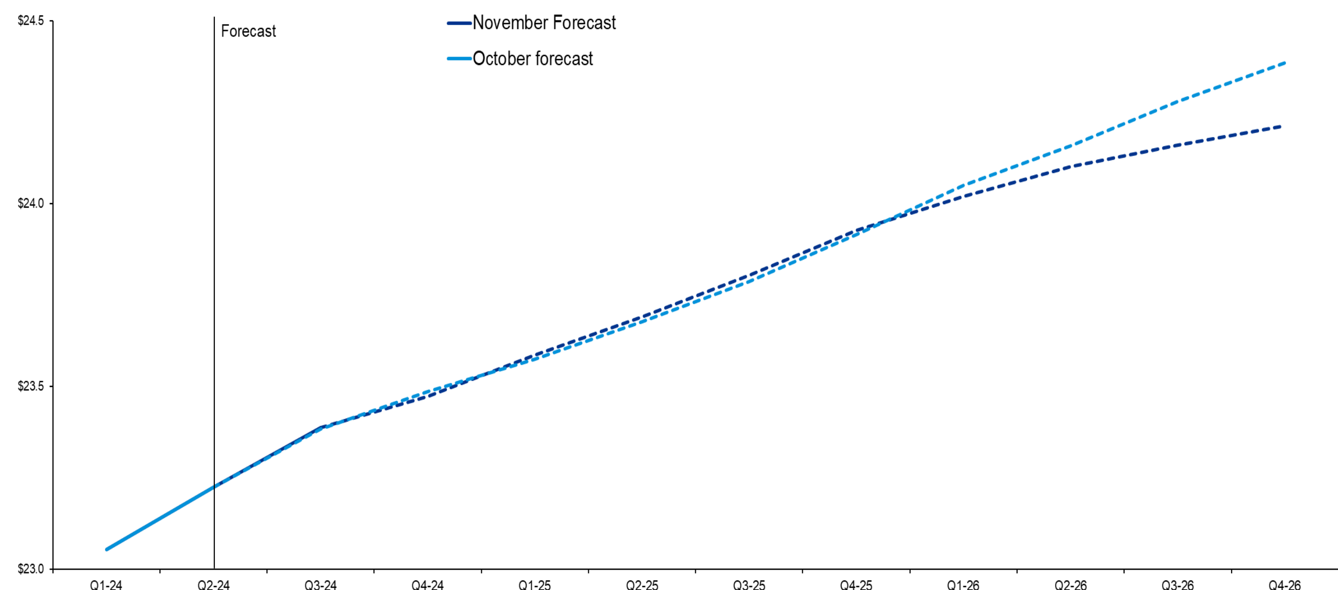
Risks. A more aggressive push by the administration on fiscal stimulus could boost growth in 2025 but at a price: higher inflation. That will force the Fed to reverse course and raise rates. The bond market is already front running the Fed.

A road map to potential policy shifts

Trade policies

Our forecast assumes a phasing-in of tariffs via executive order. Congress has ceded much of its power over tariffs.

Chart 1



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Tariffs on goods imported from China are expected to rise the most. A recent depreciation in the renminbi will dampen the impact those hikes have on import prices. Close trading allies of the US such as Mexico and the European Union could suffer sector-specific tariffs.

The effective tariff rate was much less than the stated rate the last time the president-elect was in office. His administration granted waivers to protect specific firms from the most severe tariffs. He is expected to do so again for his most ardent supporters.

Larger tariffs are probable given the president-elect's record on protectionism and desire to make good on his promises. Some tariffs have longer lead times and will not show up until 2026 and 2027. (See Chart 2)

The largest misnomer on tariffs is who bears the cost. Tariffs are borne by consumers and businesses in the country that levies them, not the countries they are levied upon. They are a tax, plain and simple.

Research on the first tariffs levied by the president-elect in 2018 revealed spillover effects to related products. Dryers went up in price by the same amount as washing machines, the target of tariffs, because the two tend to be sold together.

Tariffs are a regressive tax in that they hit low- and middle-income households harder than high-income households. That is illustrated in Chart 3, which compares the costs of tariffs relative to an equivalent-sized cut in income taxes.

The United States Mexico and Canada Agreement (USMCA) is scheduled to come up for renegotiation in 2026. A failure to approve the agreement would start the process of unwinding it by 2036. Across-the-board tariffs on Mexico have been threatened and are a violation of the agreement. That could accelerate our abandonment of the trade agreement.

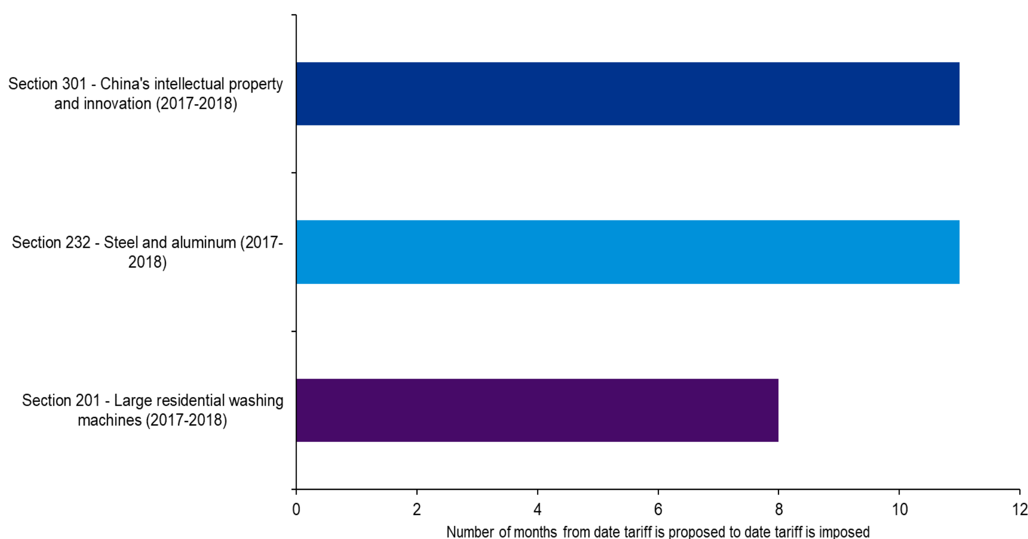
The rules around North American content rules within the USMCA will be enforced and expanded. That is harder than it appears, as most producers do not have visibility into where parts from Tier 2 and Tier 3 suppliers are sourced.

The goal is to cut imports from China, which uses other countries as a base to circumvent tariffs. That means firms will need to find ways to better track and measure their content to avoid costly tariffs and outright bans on trade, even with our closest trading allies.

Retailers and manufacturers took the largest beating in their stock prices postelection due to their reliance on imports. The vehicle and equipment industries are particularly vulnerable to an end of the USMCA, given what is now a highly integrated supply chain that flows back and forth through Canada and Mexico.

Chart 2

8 to 11 month lag between tariff proposed and tariff imposed
Number of months



Source: KPMG Economics, Oxford Economics

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Risks. Tariffs could be larger, come quicker and cover a broader swath of imports, many of which have few substitutes. Look for retaliation for those shifts, which means any move on tariffs could quickly escalate. That could trigger shortages and intensify the upward pressure on inflation.

Fiscal policy

We have assumed an extension of all personal tax cuts in the Tax Cuts and Jobs Act (TCJA) of 2017 and a modest expansion to corporate tax cuts at the end of 2025. There is a push to get tax cuts expanded in the first 100 days. Our legislative liaisons believe it will be 2026 before any major tax cuts are implemented. The TCJA personal tax cuts do not lapse before then.

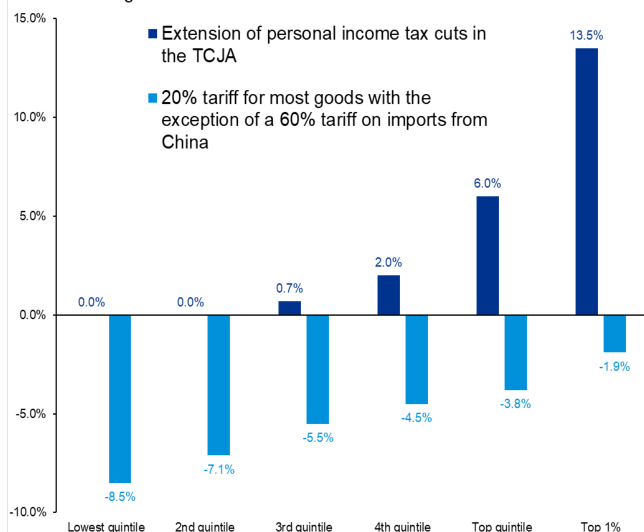
We have limited the expansion of corporate tax cuts due to the recent surge in anticorporate sentiment. Even Republicans went from viewing large corporations as favorable to unfavorable in the span of a few years.

Hardliners within the president-elect's own party will be pushing for tax revenues and spending cuts to pay for at least a portion of the TCJA tax cuts. He has proposed tariffs to do that, harking back to the trade policies of the late 19th century. The math doesn't add up, without draconian cuts in government spending.

Chart 3

Tariffs impact lower- and middle-income households harder

Percent change in after-tax income under two scenarios



Source: Peterson Institute for International Economics (PIIE)

Indeed, it is hard to escape a significant widening of the federal budget deficit. Much is baked into the cake, given the surge in retirements and uptake of Social Security and Medicare. Those who are working today pay for the benefits that accrue to retirees. That is how the system was set up nearly a century ago, when lifespans were shorter.

The president-elect has proposed repealing the Inflation Reduction Act (IRA). Republican states and the oil companies benefitted disproportionately from the subsidies and tax credits for renewable energy. We expect a portion of those to continue.

The Affordable Care Act is expected to remain intact. The coverage is extremely popular among the electorate, regardless of party affiliation. However, millions are expected to lose coverage, as Republicans allow COVID-era subsidies to lapse.

Separately, Republicans are keen to cut funding for the IRS; we expect it will succeed. This is despite the benefit/cost tradeoff of IRS funds. The Government Accounting Office estimates that 85% of households paid their taxes in full in 2021; the 15% who did not accounted for nearly $700 billion in lost revenues in 2021. That compares to the $80 billion in funding for IRS hires and technology upgrades in 2023 and 2024.

A border control bill, which was stymied in Congress during the campaign, is expected to be passed. That will reduce border crossings with increased border patrols and more judges to decide whether asylum seekers can stay.

Risks. The president-elect promised a lot more fiscal stimulus. Getting that done in the first 100 days is a heavy lift. We will likely see more stimulus in 2026 which, along with higher tariffs, will increase the upward pressure on inflation.

Regulatory shifts

The president-elect is expected to ease environmental regulations, especially on carbon emissions and public land use. Oil production hit a record high under the current administration and will move higher in the years to come.

The demands on the energy grid due to data centers and generative AI are immense. Hence, the push by the tech behemoths to secure nuclear plants and increase the energy efficiency of large language models. They have invested in renewables and are seeking ways to better store energy. They are trying to avoid the costs associated with carbon fuels.

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The easing of environmental regulations will likely be achieved via appointments to key agencies. The goal will be to scale back their funding and oversight. The Environmental Protection Agency will be a top target. The Department of Education and many health agencies are on the list as well. The full elimination of government agencies is more difficult and would require involving Congress.

Conversely, the president-elect is expected to step up regulation of hiring and training practices of firms. Look for him to expand and enforce the Supreme Court's repeal of affirmative action for higher education.

The president-elect signed an executive order late in his first term that outlawed diversity training at government agencies and government contractors. That is in addition to the push by activist investors to end diversity, equity and inclusion practices by publicly traded firms. Scrutiny over hiring policies for a large swath of firms will intensify.

Those actions could limit the talent pool that companies have to draw upon, while undermining the diversity of companies. That would compromise the boost to the quality of decision making due to diverse teams and shrink talent pools. Women, for example, currently outperform men in educational attainment.

Separately, some of the president-elect's staunchest supporters in Congress, formed odd bedfellows with their colleagues on the left of the Democratic Party. They worked to enforce more regulations on large firms and expand antitrust rulings. It is unclear how those regulatory burdens will play out.

Risks. Any short-term boost to economic activity from an easing of regulations could be offset by more restrictive hiring and training policies. That could deal a blow to diversity, productivity and economic growth.

Curbs on immigration, mass deportations

Immigration (legal and illegal) fell precipitously during the last term of the president-elect. We have assumed a similar slowdown in 2025 and 2026. That stunts population growth and constrains the size of the labor force.

Participation in the labor market falls, as foreign-born workers tend to participate at higher rates than native-born. That will worsen the drop in participation due to a surge in retiring baby boomers.

Birth rates have plummeted. The Congressional Budget Office estimates that the US population will contract by 2040, without an influx of immigrants.

That moves up the timeline on when the trust fund for Social Security could go bankrupt. More tax revenues will be needed to sustain benefits, or they will suffer automatic cuts.

We have not included mass deportations, given the lack of infrastructure to carry out that promise. Such moves would add to deficits due to the costs of such an undertaking and by removing many who pay into Social Security and Medicare. Legal and illegal immigrants pay taxes.

It is unclear how much of a crackdown there will be on employers who rely on illegal immigrants. It is hard to get illegal immigrants currently in the country to leave if they still have jobs. That would force some businesses to close entirely.

The industries most sensitive to a loss in immigration are agriculture, construction, other services (in-home care and household services) and leisure and hospitality. Immigrants often fill jobs that native-born workers will not.

Professional and business services, finance and tech rely mostly on highly educated immigrants, who slowed their arrivals during the president-elect's first term. There could be penalties levied against companies that offshore service sector jobs.

Higher education was hit hard by a shortfall in immigration last time around. Foreign students often pay full tuition and subsidize costs for native-born students. Those same immigrants are major drivers of innovation and dynamism, which fuels productivity. Four of the seven largest tech companies in the US have foreign-born CEOs.

The math on immigration and its impact on growth is important. Potential growth is a simple equation: It is the pace at which a country's labor market grows plus how productive those workers are when on the job. Curbs to immigration deal a blow to those inputs.

Risks. Labor shortages intensify, bidding up wages for some and increase the pace of business closures. That will worsen overall shortages, limit competition and further bid up prices.

Limits on the Fed's Independence

The president-elect has said the Fed should consider input from him in making decisions on interest rates. Historically, such political interference in central banking has resulted in stagflation like we experienced in the 1970s.

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It is unclear how far the president-elect would go. He has said that he would not fire Fed Chairman Jay Powell before his tenure ends in May 2026.

Powell recently underscored his resolve to stay. When asked about the possibility of being removed from his post after the November meeting, he tersely replied, “Not permitted under the law.”

Presidents typically exert their control over the Fed via appointments to the Board of Governors, including the Fed Chair. Powell was chosen by the president-elect to fill his current position. He has endured the most public criticism against a Fed chair by a president on record.

Governor Adriana Kugler’s term expires in January 2026. Powell’s tenure as chairman expires in May 2026, when he is expected to retire. That would give the president two appointments without a legal battle early in his term.

Our current forecast does not show an acceleration in inflation until 2026, which could further ease the pressure on the Fed. We expect it to continue cutting rates gradually in 2025; upside risks on inflation due to policy shifts could stop rate cuts sooner.

The law allows for the firing of Fed governors for “cause.” Rate decisions do not fall into that category, but we cannot rule out a legal battle.

The presidents of the regional Fed banks are appointed by their local boards but approved by the Board of Governors in Washington. Any major changes in the composition of the Board of Governors could tip the scales on the regional presidencies as well, but that would take time.

Congress must approve presidential appointments to the Board of Governors, which could further slow interference in monetary policy. Republican Senators drew a line in the sand on what they considered fringe candidates for the Board of Governors.

If the Fed fails to counter an acceleration in inflation, then the bond market will do the heavy lifting for it. Bond traders will push up yields to compensate for the risk that inflation could erode their value going forward.

Risks. The Fed could reverse course and raises rates, which may prompt more aggressive efforts to remove members of the Board of Governors. Efforts to interfere with rate decisions by the Fed would be countered by rising bond yields.

US dollar depreciation?

People high on the president-elect’s potential cabinet list have argued for US dollar depreciation. A repeat of the Plaza Accord of 1985, when major industrialized countries cooperated to depreciate the US dollar, would likely fail. Countries would not participate because a weaker US dollar would exacerbate the blow to their exports due to tariffs.

More importantly, the US dollar plays a much larger role in the plumbing of global financial markets than it did back then. Any coordinated depreciation would have to be accompanied by a sustained drop in interest rates and an erosion in the US dollar’s status as a reserve currency.

There are currently no challengers to the US dollar. However, efforts to find alternatives are intensifying.

The recent BRICS meeting in Russia, which was expanded to include countries beyond Brazil, Russia, India, China and South Africa is one such example. Iran, Egypt, Ethiopia and the United Arab Emirates joined.

They are looking for ways to shelter their countries from sanctions by the US and its allies; circumventing the US dollar as a form of payment is one way to accomplish that.

Risks. Efforts to depreciate the US dollar could undermine its status as a reserve currency. There are no current substitutes, but that does not prevent other countries from trying, or more chaotic movements in financial markets. Any success in weakening the US dollar would further bid up the cost of imports and inflation.

“It seems an easy bet that shifts to trade policy, curbs on immigration, fiscal stimulus and an easing of regulatory burdens will take center stage.”

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Heightened Policy Uncertainty

Measures of economic policy uncertainty spiked during the president-elect's first term. Increased volatility in everything from domestic to foreign policy fueled unease.

Research on economic policy uncertainty reveals that its largest impact is on business investment, hiring and cross-border investment. That includes mergers and acquisitions. The number of deals tends to fall, while the length of time to complete transactions rises. The premium for such transactions diminishes. That is prior to the hurdles that higher interest rates put on deal activity.

Risks. Nonresidential investment and hiring could be weaker than forecast. Multinational companies are at particular risk as they are among the most exposed to trade and escalating geopolitical tensions.

Bottom Line

The electorate has spoken; voters are angry about inflation and immigration. The suite of policy prescriptions the new government has proposed suggests that any cooling in inflation could be short-lived.

The expansion is poised to continue in 2025. However, the pace and size of fiscal stimulus, tariffs and curbs on immigration create challenges for 2026 and beyond. The inflationary effects of those shifts compound in out-years. If the Fed does not actively counter inflation with higher rates, the bond market will.

We have been through a lot since the onset of the pandemic. Efforts to further divide us are unproductive. As Thanksgiving approaches, I will focus on breaking bread instead of ties with those I love. Be kind. Pay it forward. Peace.

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Economic Forecast — November 2024												
	2023	2024	2025	2023:4(A)	2024:1(A)	2024:2(A)	2024:3	2024:4	2025:1	2025:2	2025:3	2025:4
National Outlook												
Chain Weight GDP[1]	2.9	2.7	2.0	3.2	1.6	3.0	2.8	1.5	2.0	1.8	2.0	2.1
Personal Consumption	2.5	2.7	2.6	3.5	1.9	2.8	3.7	2.6	2.3	2.5	2.2	2.1
Business Fixed Investment	6.0	3.7	2.1	3.8	4.5	3.9	3.3	-0.4	2.7	2.4	2.3	2.1
Residential Investment	-8.3	3.7	-1.2	2.5	13.7	-2.8	-5.1	-0.9	-1.5	-0.6	0.9	2.8
Inventory Investment (bil $ '17)	33	53	80	45	18	72	60	62	73	68	84	96
Net Exports (bil $ '17)	-933	-1048	-1137	-937	-977	-1036	-1077	-1101	-1119	-1132	-1145	-1151
Exports	2.8	3.5	4.0	6.2	1.9	1.0	8.9	4.3	3.7	2.9	2.7	3.3
Imports	-1.2	5.9	5.3	4.2	6.1	7.6	11.2	5.6	4.7	3.4	3.3	2.9
Government Expenditures	3.9	3.2	1.1	3.6	1.8	3.1	5.0	0.5	0.6	-0.1	0.2	0.2
Federal	2.9	2.3	1.5	-0.3	-0.4	4.3	9.7	-0.9	-0.1	0.2	1.0	1.0
State and Local	4.4	3.8	0.8	6.1	3.1	2.3	2.3	1.3	1.1	-0.3	-0.2	-0.2
Final Sales	3.3	2.6	1.9	3.7	2.1	1.9	3.0	1.4	1.8	1.9	1.7	1.9
Inflation												
GDP Deflator	3.6	2.4	2.3	1.5	3.0	2.5	1.8	2.1	2.2	2.5	2.4	2.5
CPI	4.1	2.9	2.2	2.7	3.8	2.8	1.2	2.5	2.0	2.8	1.8	1.8
Core CPI	4.8	3.4	2.6	3.4	4.2	3.2	2.2	3.2	2.4	2.5	2.4	2.4
Special Indicators												
Corporate Profits[2]	19.4	-6.0	-0.7	19.4	-6.8	15.2	5.6	-6.0	-0.2	-0.9	-0.7	-0.7
Disposable Personal Income	5.1	3.2	2.7	3.2	5.6	2.4	1.6	2.5	3.3	2.8	3.0	3.0
Housing Starts (mil)	1.42	1.35	1.34	1.48	1.41	1.34	1.33	1.33	1.33	1.34	1.33	1.34
Civilian Unemployment Rate	3.6	4.0	4.3	3.8	3.8	4.0	4.2	4.2	4.3	4.3	4.3	4.3
Total Nonfarm Payrolls (thous)[3]	3534	2478	1258	617	771	577	421	319	374	250	180	54
Vehicle Sales												
Automobile Sales (mil)	3.1	3.0	3.0	3.1	3.0	2.9	3.0	3.1	3.0	3.0	3.0	3.0
Domestic	2.3	2.0	2.0	2.2	2.1	2.0	2.0	2.1	2.0	2.0	2.0	2.0
Imports	0.9	0.9	1.0	0.9	0.9	0.9	1.0	1.0	1.0	1.0	1.0	1.0
LtTrucks (mil)	12.4	12.7	12.8	12.5	12.5	12.8	12.7	12.9	12.8	12.8	12.8	12.8
Domestic	9.9	10.0	10.0	9.8	9.9	10.0	10.0	10.1	10.0	10.0	10.0	10.0
Imports	2.5	2.7	2.8	2.6	2.6	2.8	2.7	2.8	2.8	2.8	2.8	2.8
Combined Auto/Lt Truck	15.5	15.7	15.8	15.6	15.5	15.7	15.6	15.9	15.8	15.8	15.8	15.8
Heavy Truck Sales	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.4	0.5	0.5	0.5	0.5
Total Vehicles (mil)	16.0	16.1	16.2	16.0	16.0	16.2	16.1	16.3	16.2	16.2	16.3	16.3
Interest Rate/Yields												
Federal Funds	5.0	5.1	3.9	5.3	5.3	5.3	5.3	4.7	4.3	4.1	3.9	3.5
10 Year Treasury Note	3.9	4.2	3.9	4.4	4.2	4.4	4.0	4.2	4.0	3.9	3.8	3.9
Corporate Bond BAA	5.9	5.8	5.9	6.2	5.7	6.0	5.7	5.8	5.8	5.8	5.8	6.0
Exchange Rates												
Dollar/Euro	1.08	1.09	1.10	1.08	1.09	1.08	1.10	1.08	1.09	1.10	1.10	1.10
Yen/Dollar	140.5	150.5	143.3	147.8	148.6	155.9	148.9	149.0	147.0	144.0	142.0	140.0

[1] in 2023, GDP was $22.7 trillion in chain-weighted 2017 dollars.

[2] Corporate profits before tax with inventory valuation and capital consumption adjustments, quarterly data represents four-quarter percent change.

[3] Total nonfarm payrolls, quarterly data represents the difference in the average from the previous period. Annual data represents 4Q to 4Q change.

Quarterly data are seasonally adjusted at an annual rate. Unless otherwise specified, $ figures reflect adjustment for inflation. Total may not add up due to rounding.

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