Strategas Washington Research Analyst Jeannette Lowe breaks down the recent House of Representatives speaker turmoil, and explains how that fight is a proxy for the larger and more challenging spending issues facing policymakers.

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ROSS MAYFIELD: Your team has mentioned that the Speaker of the House turmoil was a proxy for more complex budget and spending issues in Washington. With the Speaker drama now behind us, what’s your updated read on things?

JEANNETTE LOWE: The three-week struggle to find a new Speaker showed where the Republican caucus is right now. Now that the Speaker fight is over, we’re seeing first steps on a budget for fiscal 2024. The president put forward a $106 billion national security supplemental budget request for Israel, Ukraine, Taiwan, and the southern border, as well as a $56 billion domestic request. The new Speaker, Mike Johnson, put forward his own bill for Israel aid, but it includes a $14 billion cut in enforcement funding for the IRS as an offset. This may not ultimately fly, but it shows how these budget fights might occur.

Which is to say, there will be more focus on offsets for new spending bills, especially as net interest costs on the national debt ramp up. These costs have surpassed 14% of tax revenues, historically the inflection point for a shift from fiscal accommodation to fiscal austerity. Essentially, tension is building up over how the federal government will pay for all the things that it’s doing, especially if we’re looking at even more spending for national security. We’re watching the bond market for how it reacts to any new bills (i.e., are bond vigilantes making a comeback?) because we’re already seeing upward pressure on long-term yields from supply/demand issues.

ROSS: Zooming out further, where are the big spending battles over the next 3, 5, or 10 years?

JEANNETTE: While we do have a budget fight coming up this month, geopolitical pressures could be strong enough that we don’t actually see many spending offsets in the near-term. The 2024 election is probably going to put a little bit of a damper on this theme as well, because policymakers tend to avoid imposing fiscal austerity ahead of reelection campaigns. But the pressures are only going to keep growing, so we could see more action beyond 2024. Could there be tax increases? Could there be more spending cuts? That’s what we’re really watching for.

The new Speaker supports entitlement reform and will form a bipartisan debt commission to look at shoring up entitlement programs. Past that, the individual tax cuts enacted in 2018 will expire at the end of 2025. And while both parties would like to keep those cuts, fiscal pressures could make it difficult (or at least, there may need to be more spending offsets). So those are the things we’re watching, particularly post-election. And then all of this is colored by the fact that it’s not going to be easy to bring down net interest costs as a percentage of the federal budget, particularly if interest rates do stay higher for longer. That may put more pressure on the Federal Reserve to cut rates sooner than it normally would because of the fiscal situation in Washington. These fiscal pressures will be central to the policy debate in Washington for the years to come.
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