On The Mark

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Unpacking One Big Beautiful Bill Act

Key Takeaways

- The key provisions of the One Big, Beautiful Bill Act focus on tax cuts, defense and immigration spending, and cuts in Medicaid and food assistance.
- For markets, the passing of the bill eliminates tax policy uncertainty, addresses the debt ceiling, and provides some incremental fiscal stimulus, but also raises the deficits.

What's in the Bill?

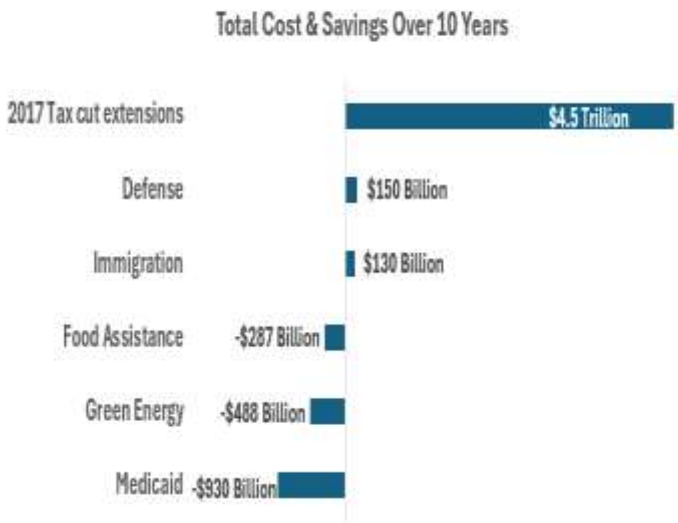
The One Big Beautiful Bill Act (Act) was signed into law with a narrow majority. The key provisions of the Act focus on taxes, additional defense spending, and immigration. The costs are partially funded through cuts in Medicaid and food assistance.

On taxes, the biggest expense was making the 2017 Tax Cuts and Jobs Act permanent. This will keep the corporate tax rate at 21% and the top federal income tax rate at 37%. The Act also provides temporary tax breaks for overtime, tips, and deductions for state and local taxes (SALT) for certain taxpayers through 2028. Finally, within taxes, while the Act does not eliminate taxes on social security, it does provide some tax breaks via deductions through 2028.

For defense, it includes about $150 billion in funding for Navy shipbuilding programs, development of the "Golden Dome," nuclear deterrence, and rare minerals production. The Act also includes $130 billion in immigration-focused spending, including building the border wall and enacting greater immigration enforcement measures.

The spending is partially offset by cuts in Medicaid, nutrition assistance, student loans, and by eliminating or reducing the tax credits for clean energy production and electric vehicles offered through the 2021 Inflation Reduction Act.

Separately, the Act also raises the debt limit by $5 trillion, ensuring the next debt limit increase will not need to occur until after the 2026 midterm elections.



Source: Congressional Budget Office Estimates

How Does It Affect the Economy?

The Act, while big in size, lacks a big punch as the majority of the cost was spent on making the existing tax cuts permanent. The Act is estimated to boost economic growth somewhere in the range of 0.5% to 1.2% over 10 years, according to the Tax Foundation and the Penn Wharton Budget Model. The large cost also adds to the deficit. The Committee for a Responsible Federal Budget estimates it could add $4.1 trillion to the deficit over the next decade, or $5.5 trillion if all tax cuts are made permanent. The deficit estimates do not include any benefits that may accrue from additional growth due to the stimulus. The side effect of the Act's higher deficit is that it increases the odds of higher tariffs staying in place to partially pay for it.

Estimating tariff revenues is challenging given the ongoing negotiations. Models from Yale Budget Lab show that, even when tariffs are included, the Federal debt still increases.

What Does It Mean for Markets?

For markets, the Act eliminates tax policy uncertainty, addresses the debt ceiling, and provides some incremental fiscal stimulus, but also raises the deficits.

While the Act, as a whole, provides a limited boost to growth, the timing of the different provisions makes a difference. The tax cut provisions in the Act are front-loaded through 2029, while spending cuts are backloaded through 2034. Thus, the combined impact of tax cuts, tariffs, and some spending cuts still provides a net stimulus to the economy, which would be a tailwind to equities in the near term.

While the Act may be good news for stocks, bonds face a different outlook, as investors are likely to demand higher interest rates for the larger debt burden. As bond prices move in the opposite direction of interest rates, this could mean limited upside and even losses on longer maturities.

For investors, shorter maturity bonds can be a sensible choice to manage deficit concerns. They provide ballast against interest rate volatility as they are less susceptible to price changes that occur with interest rate fluctuations, while also providing ballast against stock market volatility.

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