

## US Watch

# 2025 OUTLOOK – STRONG GROWTH, IF POLICY CAN UNLOCK IT

Steven Blitz

- Getting the private sector to lever assets to expand capital investment is key.
- We think 3% real growth and 3% inflation in 2025; chaotic policy is the risk.
- Easy fiscal & easy money in a growing economy with a liquidity overhang means inflation, a positive yield curve, a wider term premium, and a weaker dollar (maybe).

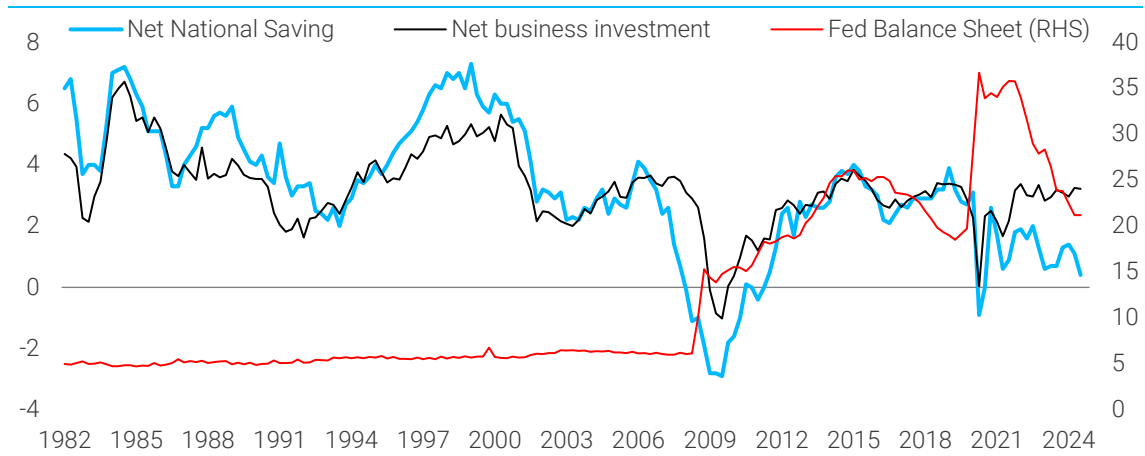
**The road to recession runs through the asset side of private sector balance sheets, the road to growth runs through liabilities. The 2025 outlook consequently depends on reviving the private sector's willingness to lever assets to expand capital spending.** The stars are aligned for this outcome. There is the outsized liquidity base off which the private sector can borrow and spend, after more than a decade of deleveraging and monetization of the deficit, a positive yield curve incentivizing banks to lend, and the promise of lower taxes and reduced regulation, among other incentives. Inflation risk is also real – this will be the first time in decades when an expansion year is underpinned by easy monetary and fiscal policies combined with an overhang of liquidity. A positive yield curve and a wider term premium is the immediate result. A weaker dollar should be as well, but tariffs and still slow global growth may keep a bid under the dollar in the near term.

**No outcome is ever assured.** Potentially working against this upside outlook is the expanding budget deficit and the Fed's willingness to use its balance sheet to manage the consequent upward pressures on real yields. Then there is the potential for the Trump administration to be chaotic enough in its execution, and too late in responding to the unintended consequences of its actions. These are among any number of events that could stall private spending plans, weaken equities, and further reduce the demand for labor. The current economy clearly leans towards growth, but things can unwind quickly enough to set off a mild recession.

**Major new initiatives that incoming administrations put into play always carry the risk of significant unforeseen consequences** (see Biden and inflation). The potential risks attached to Trump's promises are potentially significant as well, and perhaps more so by threatening to upend the global trading system just when the US need for global capital is large and growing. As evidence, note that the US net national saving rate (household and business saving plus government dissaving) is effectively zero as a percent of GDP and keeps shrinking (Chart 1). That, in turn, reduces domestic business capital investment net of replacement. The Fed balance sheet has, for now, sustained capital spending by keeping real rates from rising to where they could go if, instead, 100% of the Federal budget deficit had to be financed in private markets. The Fed, through QE, essentially injected itself as another saver into the S=I equation.

**Chart 1: Less saving, less net capex -- Fed rescue, for now.**

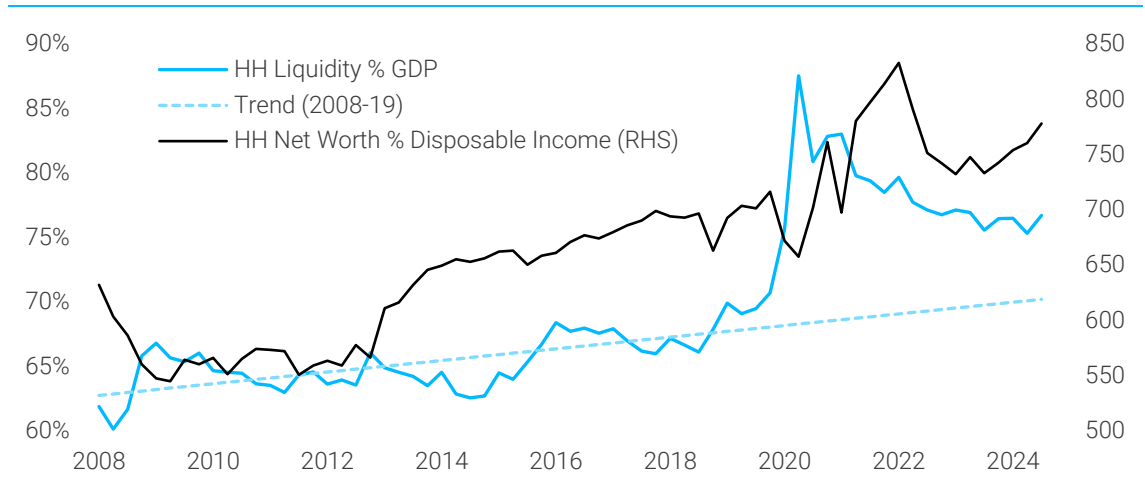
Data expressed as a percent of GDP



Source: BEA, Federal Reserve, GlobalData. TS Lombard

**Nevertheless, we take the upside bet on growth, relying on Trump’s sensitivity to the equity market as barometer of his success and the deep market experience of his team to keep some of his more chaotic instincts in check.** These days, the “vigilantes” toil in the equity market, where households are overinvested. In turn, high volatility risk keeps money earning a safe positive real return in cash rather than moving into the real economy. To be clear, the money is there to supporting leveraged spending -- household liquidity remains at extraordinary levels, so too the ratio of net worth to income (Chart 2).

**Chart 2: The overhang of household liquidity is still here for banks to lend.**

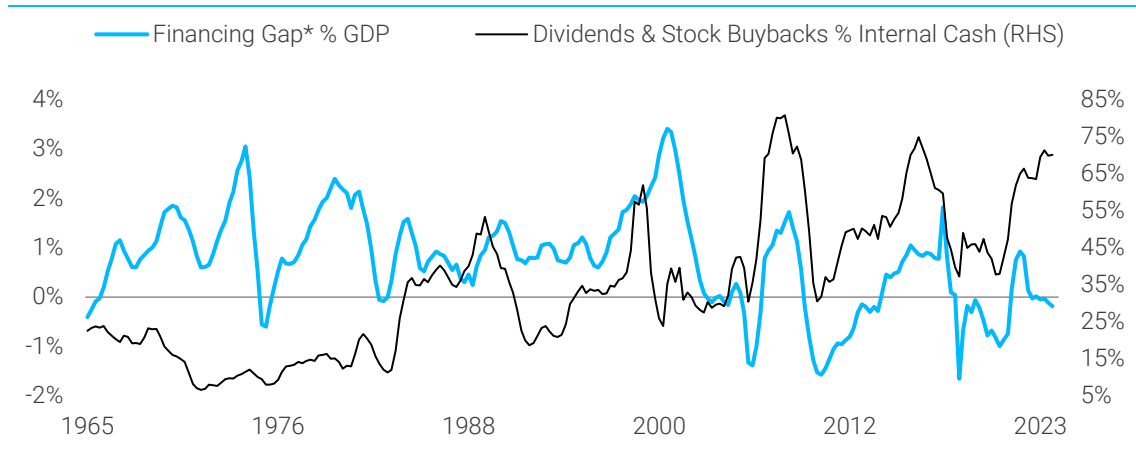


Source: Federal Reserve, GlobalData. TS Lombard

**The challenge for Trump’s policies is to reverse the long rising trend of firms using internal cash to fund dividends and buybacks rather than capital spending** (Chart 3). On a four-quarter moving average basis, some 70% of internal funds are being used to return capital to shareholders. The financing gap (capex minus internal funds) is, on the other hand, negative. The two series have been on a diverging trend since the 2001 recession – not surprising given the shift to use productive capacity outside the US and, in turn, earn the wide margin. This structure creates little reason to hold onto the capital. Trump’s proposals are being designed to shift the incentives back towards using internal cash to underwrite domestic capex.

**Chart 3: Trump’s challenge – getting firms to invest cash in capital rather than returning it to shareholders.**

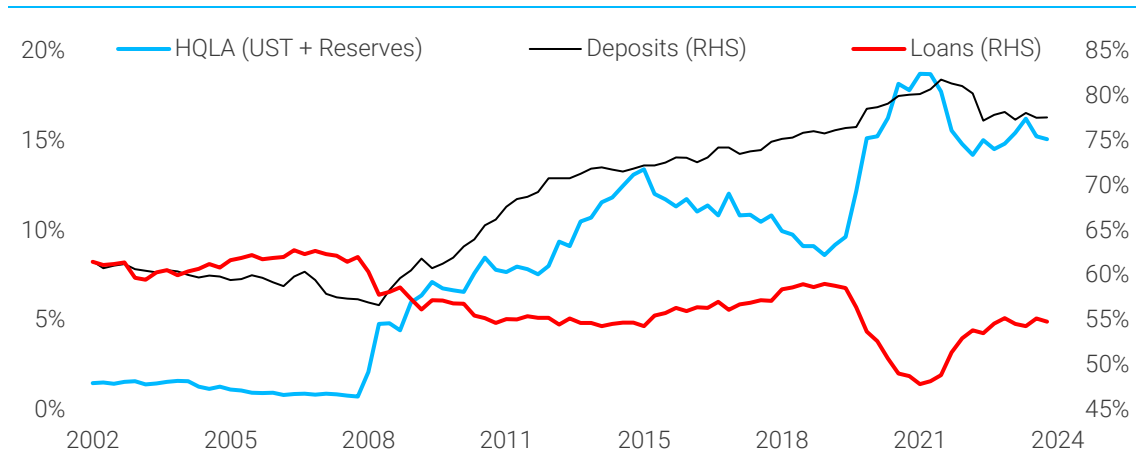
\*Financing gap is capex minus internal funds



**Banks, being intermediaries, have those high cash balances among households and business available to lend.** What banks need is for the short end of the yield curve (3M-3Y) to flip positive to restore profit in lending. It is almost there and looks set to return to about a 50BP positive spread – good news for bank earnings. At present, the inverted curve is helping to restrain growth in loans and leases to around 2% SAAR, below inflation and, more critically, nominal GDP. The broader banking picture is too many deposits relative to loans, a direct result of QE. Banks are also holding a higher percentage of HQLA than required. When the time is ripe, as from late-21 to late-22, deposits at the Fed will be swapped into loans. Inflation is always financed, and banks are ready to do their part. The Trump administration is also angling to reduce bank capital requirements – which could significantly add to bank lending potential.

**Chart 4: Banks have plenty of excess to convert into loans.**

Series expressed as a percentage of bank assets



Source: Federal Reserve, GlobalData. TS Lombard

**Given this expected favourable backdrop in 2025, economic and regulatory, and current upward momentum in growth, it is reasonable to expect liquidity balances to shift into the real economy during the year ahead.** The pace of real nonresidential and residential fixed investment should, at least, rise to their median Y/Y growth rates of the 2012-19 period in 2025 – which was

not very high by historic standards. **The great era of deleveraging balance sheets is primed to end but it is up to Trump and his policies to spark the shift.**

**On a Q4/Q4 basis, expect real GDP to grow 2.9% (2.7% this year), core inflation to be around 3%, and unemployment to end up at 4%. Powering the economy will be 4.6% real growth in non-residential fixed investment (4% this year) and 5.2% growth in residential fixed investment (1.7% this year). Real Federal spending should slow from 24% of GDP to 23.5%, essentially 3.8% real growth (Q4/Q4), down from 4.3% in 2024. As for the Fed, inflation at 3% is not their objective but neither is creating a recession to pull inflation back to 2%.**

**If real growth is above “potential” as expected, and inflation is around 3% and leaking higher, with a 4.25%-4.50% funds rate in place, the implication is for a higher neutral real rate for funds -- but the FOMC will be hard pressed to find anyone to support tighter policy.** Trump, on the other hand, may want policy rates lower, but he will be hard pressed to find the route to a lower structure of yields without creating an inflation/dollar problem given the budget deficit running at 6%-7% of GDP. Productivity is not yet a proven escape route. Current numbers are too finance sector biased to be believed and reshoring manufacturing activity lowers productivity growth by pulling work hours back into the domestic economy -- the bulk of the US trade deficit is US firms sourcing production outside the US.

**Looking past 2025, unsettling risks loom, beginning with the current easy monetary and fiscal policies at a time of economic expansion, with an overhang of liquidity, and the potential for tariffs to upend the system of global capital flows in place since the mid-80s.** The Fed's balance sheet is the fulcrum on which inflation, growth, and the sustainability of needed foreign capital inflows are all balanced. Keeping such balancing acts in place become a problem when things begin moving too far out of kilter. Inflation is always financed, and plenty of financing will be available in 2025 for loans and M&A. Then there is the upward pressure on wages as improved growth tightens labor markets. Lastly, and perhaps most significant, are broad-based tariffs and the potential knock-on negative impact on global capital flows.

**The economy of the 1960s is not exactly the economy of today, but similarities including the direction of monetary policy are troubling.** The 1960s mismanagement of domestic policy within a fixed-exchange rate system and growing global trade led to the collapse of Bretton Woods and 60s inflation turned into a series of global commodity shocks that sent 70s inflation spiralling upward. Today, despite net inflows of capital equalling 4% of GDP and net national saving at 0%, the stable system of global capital inflows will be challenged by a massive tariff scheme used, in part, to help finance the budget deficit. If this Fed must choose between shoring up the current system of capital at the expense of curtailing real growth, they will lean to keep growth going.

**In sum,** all is set for a strong year of growth, and it will be stronger if Trump's policies can unlock household and business leverage to support capital spending – what we expect. If, however, policy chaos instead causes people to be more cautious than daring, recession risk is very much present. The ultimate barometer for Trump is the equity market, and this should keep policies in line with sparking domestic capital spending rather than scaring it – and Fed policy will be more supportive than not. As markets adjust to a different trajectory for the funds rate, I expect the 10Y yield to be pushed over 5% and perhaps higher with the term premium widening back to 100BP. Beyond 2025, easy monetary and fiscal policies during an economic expansion with an overhang of liquidity while, at the same time, upsetting global trade flows to the extent capital flows are compromised in response, creates a problematic 2026.

## Authors



**Steven Blitz**

Managing Director,  
Chief US Economist

## Disclaimer

This report has been issued by TSL Research Group Limited in conjunction with its subsidiaries Lombard Street Research Limited, Lombard Street Research Financial Services Limited, and Trusted Sources UK Limited (together "TSL Research Group"). This report is intended to be viewed by clients of the TSL Research Group only. The contents of this report, either in whole or in part, shall not be reproduced, stored in a data retrieval system or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise without written permission of TSL Research Group.

The information and opinions expressed in this report have been compiled from publicly available sources believed to be reliable but are not intended to be treated as advice or relied upon as fact. Neither TSL Research Group, nor any of its directors, employees or agents accepts liability for and, to the maximum extent permitted by applicable law, shall not be responsible for any loss or damage arising from the use of this report including as a result of decisions made or actions taken in reliance upon or in connection with the information contained in this report. TSL Research Group does not warrant or represent that this report is accurate, complete, or reliable and does not provide any assurance whatsoever in relation to the information contained in this report. Any opinions, forecasts or estimates herein constitute a judgement as at the date of this report based on the information available.

There can be no assurance that future results or events will be consistent with any such opinions, forecasts, or estimates. Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied is made regarding future performance. This information is subject to change without notice, its accuracy is not guaranteed, it may be incomplete or condensed and it may not contain all material information concerning the company and its subsidiaries. The value of any securities or financial instruments or types of securities or financial instruments mentioned in this report can fall as well as rise. Foreign currency denominated securities and financial instruments are subject to fluctuations in exchange rates that may have a positive or adverse effect on the value, price or income of such securities or financial instruments. This is a generic research report and as such does not have regard to the specific instrument objectives, financial situation, and the particular needs of a client. Clients should seek independent financial advice regarding the appropriateness of investing in any of the types of financial instrument or investment strategies discussed in this report.

By reading this report you accept [TS Lombard's terms and conditions](#).

Registered Office: John Carpenter House, John Carpenter Street, London, England, EC4Y 0AN. Registered in England No. 10232483