

## Flash Note 03/01/2018

Alex Fusté  
[@AlexfusteAlex](#)  
[alex.fuste@andbank.com](mailto:alex.fuste@andbank.com)

### **The US tax reform. The likely broad effects and the specific ones.**

#### **The tax reform: The main points we must know**

- Most individuals will get a cut in federal income tax until 2025.
- Corporations will get a permanent tax cut.
- Corporations will be able to fully expense investments for the next five years, starting immediately.
- Corporations' foreign profits will be taxed at reduced rates. Accumulated stocks of cash will be taxed at special reduced rates and future flows will be subject to a "global minimum tax" of 10-12.5%. The US companies which pay lower rates to foreign governments will be obliged to make up the difference to the US.
- The deductibility of business interest expenses will be capped.
- Obamacare's individual mandate for health insurance will be scrapped.
- The Arctic National Wildlife Reserve will be opened up to oil drilling.

#### **The broad foreseeable effects**

- Federal deficits are likely to rise by up to US\$1.5trn over the next 10 years
- Domestic business investment will get a boost. The reduction in the corporate tax rate from 35% to 20% and the promise of a five-year window in which all investment can be

fully expensed will act as a powerful incentive for companies to bring forward capital expenditure.

- Future US productivity will get a boost: If businesses invest well, and overseas profits (as it seems could happen) are to be allocated more efficiently, the resulting capital deepening could boost future productivity growth. Why? To avoid taxes, US corporations have built up cash piles overseas. Most is invested in treasuries anyway, via offshore accounts, but still, there are clear benefits from this reform since companies will be free to reallocate their overseas profits as they see fit (under-funded pension plans, pending capex, debt repayments or simply distributing cash to investors via dividends or share buybacks). No matter which way US corporations may use, this extra freedom will probably (as usual) enhance productivity.

### **The more specific effects (on Financial markets)**

- Tax reform is bearish for bonds.
- The picture for equities is mixed. Corporate tax cuts are good for stocks but equity valuations may come under pressure if bond yields start rising.
- Reform may be near-term bullish for the US dollar: Corporate tax cuts may encourage foreign inflows into US equities, while higher US long rates could also attract foreign capital (the competition for yield is bleak out there).
- With a longer-term view, many analysts still believe that the USD is slightly overvalued and consequently they remain structurally short in the greenback. Based on this widely accepted premise, the dollar could remain under pressure in 2018. However, (and I'm going to risk crossing a swampy terrain again) if we finally see this boost in productivity in the US, -as is often the case with permanent tax cuts-, then what will follow will be the obvious results of a jump in productivity. That is to say (1) higher potential GDP with (2) controlled inflation, which usually ends being reflected in a stronger currency. What I do not dare to do today is to tell you when all this can materialize (specially in view of my recent and poor track-record in my projections for this currency).

Best regards