

POLITICAL PULSE

Donald and Chuck and Nancy and Tax Cuts

Friday, September 15, 2017

Donald Luskin**Trump isn't consorting with the enemy – he's using Dems to lock in a tax cut win.**

All week clients have been asking us about [what is being touted](#) as President Donald J. Trump's buddying up with Democrats. This week's events have only confirmed what we said about it last week after Trump brokered a debt ceiling deal with Senate Minority Leader Chuck Schumer (D-NY) and House Minority Leader Nancy Pelosi (D-CA) (see ["Debt! NoKo! Irma! DACA! Cohn! ...and Other 4-letter Words"](#) September 7, 2017). *Trump is displaying a new level of engagement with and mastery of the president's role in managing Congress. It makes us more confident than ever in our contrarian view that tax cuts will be enacted this year.*

- *Don't conclude, just because Trump is working with Democrats, that he [has abandoned his pro-growth policy agenda](#), or [betrayed the GOP's agenda](#) with which it strongly overlaps. Quite the contrary.*
- Trump's "deal" last week to avert a debt ceiling crisis did a favor for Senate Majority Leader Mitch McConnell (R-KY) and House Speaker Paul Ryan (R-WI) – and we're sure they know it. If they didn't like the deal, they would not have brought it to a vote – but they did, instantly.
- It enlisted literally unanimous Democratic "yea" votes in both the [Senate](#) and the [House](#), allowing fiscally conservative Republicans the luxury of voting against it.
- [Reports in the media](#) that it "sets up a brutal year-end fiscal cliff" are just plain wrong. In reality, *it gives valuable timing options to the GOP to deal with the debt ceiling again at any time they choose between now and next June.*
- That's because, though last week's legislation was almost universally [misreported](#) as "raising" the debt ceiling, it in fact *suspended* the debt ceiling through December 8. Till then, the US Treasury can borrow without any limits at all. This borrowing will not only finance the government. Critically, it will replenish the accounts that Treasury depleted as part of ["extraordinary measures"](#) to meet cash-flow requirements over the six months since the expiration of the prior debt ceiling suspension March 16. After the new suspension ends on December 8, Treasury will have six months or so – all over again – in which it can use all the same "extraordinary measures".
- *And all the Washington inside baseball aside, don't forget that Trump's intervention may have been the key to averting a debt*

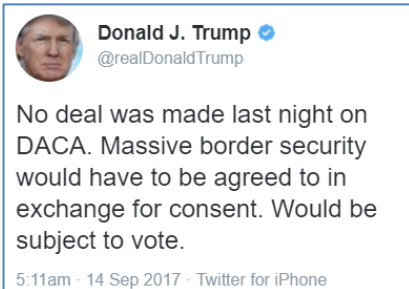
Update to strategic view**US BONDS, US MACRO:**

For all the controversy about his compromising with Democrats, Trump's intervention averted a debt ceiling crisis, as evidenced by the 20 bp back-up in the 10-year. The price was not a December debt cliff – after the December 8 expiration of the debt ceiling suspension, Treasury can employ "extraordinary measures" for at least six months. Trump is not betraying his pro-growth agenda, nor his party, by interacting with Schumer and Pelosi. Democrats have to be engaged for must-pass and politically difficult legislation like the debt ceiling and DACA reform. Trump's brokering a DACA deal could trigger a long-term realignment of Hispanic votes to the GOP. On tax cuts, Democrats are not being courted – they are being pressured, by a road-show passing through their most vulnerable states in 2018. We think tax cuts are heading for the finish line. The deductibility of state and local taxes is shaping up to be a key negotiating chip, as we predicted.

[\[Strategy dashboard\]](#)

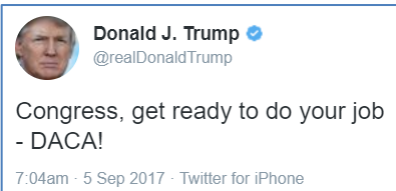
crisis. We're delighted to see the relaxation of risk aversion that has followed, with the 10-year Treasury backing up more than 20 bp since we said a debt deal would mean we'd seen the worst in yields (again, see "[Debt! NoKo! Irma! DACA! Cohn! ...and Other 4-letter Words](#)").

- But back to the inside baseball... What did the Democrats get out of it? Not much was required. They were going to have to facilitate a debt ceiling vote anyway – it's absolutely must-pass legislation, and neither party can do it alone. If nothing else, for his help on the debt ceiling, Schumer got himself [a New York Times headline](#) on Saturday hailing him for pulling off a "Power Play." But in reality, as [McConnell explained to the Times](#) on Monday, because this was a debt ceiling *suspension* that would effectively last through summer, Schumer's power play was "not quite as good as my counterpart thought it was."
- Maybe an invitation to dinner at the White House to talk about Deferred Action for Childhood Arrivals (DACA) Wednesday night



was part of the debt deal. But so far that hasn't worked out well for Schumer and Pelosi. They put out [a premature statement](#) Wednesday morning that a deal had been reached, which they [had to retract](#) later in the day after Trump [contradicted them](#).

- For connoisseurs of fake news, we highly recommend [this front-page story in today's Times](#), in which this embarrassment to Schumer and Pelosi is portrayed as "newfound clout," as having "made real a possible deal" that "left Republican leaders in Congress scrambling." The story quotes Schumer gloating on the Senate floor about how at the dinner he coached Trump on politics, and bragging, "He likes us; he likes me anyway."
- We're not saying a deal won't get done. The reality is that from the moment Trump [announced a week ago Monday](#) that he intended to wind down DACA in six months, to give Congress time to legislate an alternative, *he said he would seek a solution "with heart and compassion."* His purpose was never to abolish DACA outright and deport 800,000 young people – a political non-starter at the national level, even among Republicans. Trump understands that immigration hard-liners can't win on DACA



abolition, just as pro-choice Democrats know they can't win on partial birth abortion. Obamacare has similar dynamics, which is why, for all the repeal-and-replace campaign rhetoric of the last seven years, the GOP hasn't been willing to act when push comes to shove.

- So as much as the liberal media is bragging and the [conservative media is squawking](#), Trump is out-flanking the Democrats on DACA and doing the GOP a big favor – just as he did on the debt ceiling. His enlisting of Democratic votes will allow GOP hard-liners the luxury of voting "nay." And because in this case the Democrats want to vote "yea" anyway, he'll be able to extract their assent to

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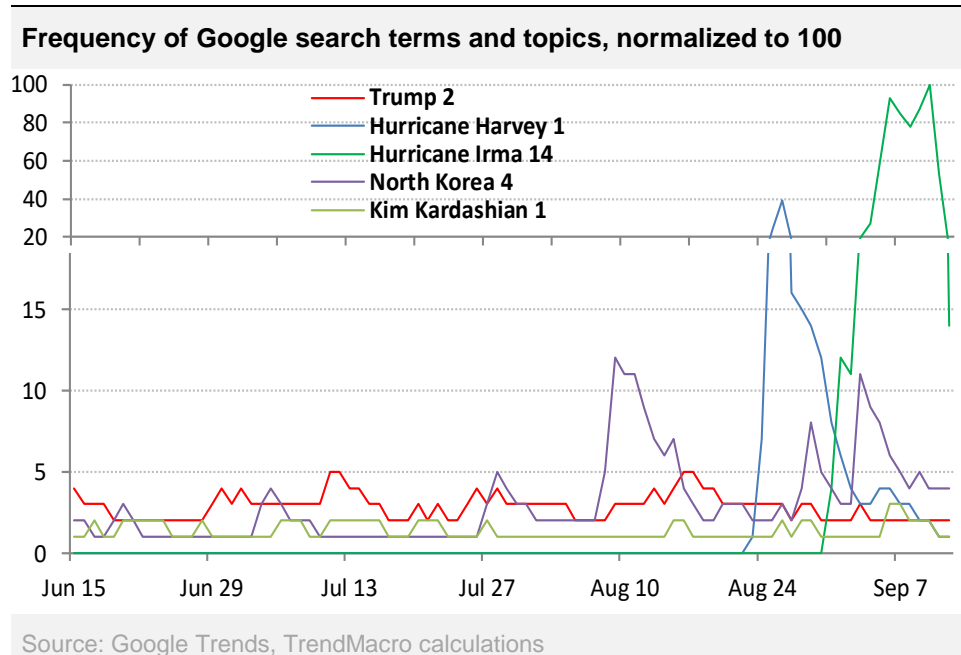
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border security measures that will give the GOP even more political cover. The wall? That's a detail. And remember, like the debt ceiling bill, a DACA bill reflecting a Trump "deal" won't even come to the floor if McConnell and Ryan don't like it.

- [Some have likened](#) Trump's surprisingly soft position on DACA as a "Nixon goes to China" moment. We liken it more to the embrace of civil rights in the 1960s by segregationist Lyndon Johnson, whose repositioning of the Democratic party allowed it to capture the African American vote forever after. Anti-immigrationist Trump can do the same thing now with the Hispanic vote – the fastest growing political demographic, and one not implacably tied to the Democratic party nor to the progressive agenda. *Mark our words – if Trump can pull this off, in 2020 he'll be campaigning successfully for Hispanic votes, and setting in motion an historic realignment.*

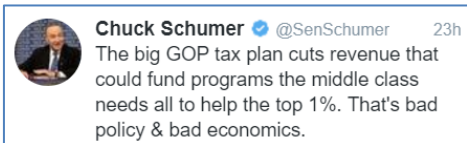
We think Trump is on track to outflank the Democrats on tax cuts, too.

- False media accounts claim that Trump is ["wooing Democrats."](#) The reality is that he is targeting them.
- [He has planned a multi-state barnstorming tour](#) focused on vulnerable Democrats. He'll be doing rallies to promote tax cuts in Florida, Indiana, Michigan, Montana, Ohio and Pennsylvania – all states that Trump won in 2016, where Democratic senators are up for re-election in 2018. He's already hit two others like that – Missouri and North Dakota.
- By pressuring vulnerable Democrats like Claire McCaskill (MO), Heidi Heitkamp (ND), Joe Manchin (WV) or Joe Donnelly (IN), Trump not only moves, step by step, toward 60 votes which could unlock enduring tax reform. He also assures that at least *something* will get done under reconciliation, by lining up a few Democratic pinch-hitters if he loses a couple of balky Republicans.
- *Note that by doing a tax-cut road show, and by visibly deploying his Treasury secretary and National Economics Council director in*



constant media appearances and Washington negotiations, Trump is engaged with tax cuts in a way that was utterly lacking in the drive to repeal-and-replace Obamacare.

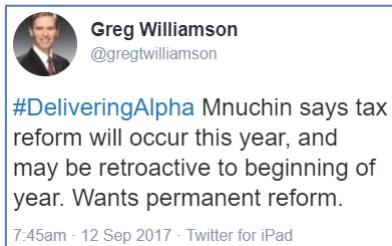
- And having said and done all the right things to deal with Hurricanes Harvey and Irma – and, not coincidentally, having been bumped out of the headlines for two weeks by these disasters (please see the chart on the previous page) – Trump has worked his approval ratings back up to where they were before the Charlottesville hysteria (see ["The Charlottesville Hysteria"](#) August 18, 2017). It's the perfect moment for him to go on the road for tax cuts.
- Meanwhile, Trump's supposed deal-mate Schumer is running what appears to be a rear-guard action. [He reportedly said Tuesday](#) that Democrats would block Trump's plan to end the deduction for state



and local taxes – claiming that would make a mockery of Trump's promises to target tax relief to the middle class. We fail to see how eliminating a deduction that mostly benefits rich Democrats

hurts the middle class. But the key here is that Schumer has signaled that preserving the SALT deduction will be a key Democratic negotiating point – just as we predicted he would (see ["Trump's Tax Cut Nuclear Option"](#) May 1, 2017). Treasury Secretary Steven Mnuchin [has made sure](#) that Schumer knows it's very much on the table. It's what Trump can trade away to get tax cuts done.

- We're getting to the finish line. [The GOP said Wednesday](#) that details of its tax cut plans will be released the week after next.



Surrogates are starting to talk about some of the minutiae, giving the impression that the big issues have been agreed, or at least creating a demand effect by presuming agreement. For example, Mnuchin [has started talking](#) about the arcana of exactly how a cut in the corporate tax rate would apply to passthrough entities, and he hinted that tax

cuts might be backdated to the beginning of 2017.

Bottom line

For all the controversy about his compromising with Democrats, Trump's intervention averted a debt ceiling crisis, as evidenced by the 20 bp back-up in the 10-year. The price was not a December debt cliff – after the December 8 expiration of the debt ceiling suspension, Treasury can employ "extraordinary measures" for at least six months. Trump is not betraying his pro-growth agenda, nor his party, by interacting with Schumer and Pelosi. Democrats have to be engaged for must-pass and politically difficult legislation like the debt ceiling and DACA reform. Trump's brokering a DACA deal could trigger a long-term realignment of Hispanic votes to the GOP. On tax cuts, Democrats are not being courted – they are being pressured, by a road-show passing through their most vulnerable states in 2018. We think tax cuts are heading for the finish line.

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