

MACROCOSM

Tax Cuts Start to Get Real

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Just another term-sheet? No, the “unified framework” is the real thing. Tax cuts are coming.

Clients have reached out to us to ask for our quick-take on yesterday’s release by the GOP of its “Unified Framework for Fixing Our Broken Tax Code ([whole thing](#), [summary](#)). In one sense there’s not much to say, because *this “framework” isn’t much more detailed than, nor substantially different from, the White House term-sheet released in late April* (see [“On Trump’s Tax Cut Proposal”](#) April 26, 2017), or for that matter the statement on the Trump campaign website throughout the 2016 primaries and general election (see [“Trump’s the One”](#) May 4, 2016).

- So there’s little point in our commenting on any of the familiar components in the proposal.
- We’ll get into micro-debates about the relative advantages of such things as immediate expensing and a deemed-repatriation tax in future reports, when more particulars are known.

But in another sense, the very fact that yesterday’s framework is so familiar is evidence that this plan is President Donald J. Trump’s own vision. And despite the narrative about his inability to unify the GOP, he has been able to enlist his party in support of it. It speaks volumes that yesterday’s proposal was announced as a “unified” framework – self-consciously signaling the GOP’s awareness that it needs to unify, and be seen as unified. Make no mistake about it – this unity is around Trump’s vision, with distracting and dilutive alternatives such as House Speaker Paul Ryan’s beloved Border Adjustment Tax thrown overboard (see [“Drop the BAT and Run”](#) July 31, 2017).

- This demonstrates that Trump is continuing to grow in his mastery of his role as leader of a governing party. He has corralled the fractious GOP into his vision, and with his catalyzing a debt ceiling deal, he cleared the legislative calendar so that it can be processed (see [“Donald and Chuck and Nancy and Tax Cuts”](#) September 15, 2017).

As his own vision, Trump is taking this very seriously. He let Obamacare repeal-and-replace twist in the wind, supporting it with only the occasional tweet – because he was never very interested in it to begin with, and because he saw it as a lost crusade. But Trump has already made three stops on [a multi-state barnstorming tour](#) to promote tax cuts – deliberately

Update to strategic view

US MACRO, US STOCKS, US BONDS:

Yesterday’s GOP “unified framework” for tax cuts is another skeletal document, very light on specifics. In almost all ways it is Trump’s vision – it is just what he campaigned on, and it shows his growing mastery that the fractious GOP is making a self-conscious show of being “unified” behind it. Trump has taken his barnstorming tour to a third red state with a vulnerable Democratic senator, and the threat of eliminating the deduction on state and local taxes remains a nuclear option for the end-game, to secure Democratic votes in the Senate. We think markets are moving a little toward believing that tax cuts are possible. As proposed, these tax cuts would be a powerful supply-side shock, leading to faster growth, upside for stocks, and higher bond-yields.

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hitting states he carried in 2016 in which a vulnerable Democratic senator is up for re-election in 2018. He started with Claire McCaskill's Missouri and Heidi Heitkamp's North Dakota, and yesterday [he hit Joe Donnelly's Indiana](#). He's creating grass-roots support for tax cuts – setting up a national demand-effect for Congress to get it done this time, much as Barack Obama did to pass Obamacare in 2009 – and at the same time enlisting a critical few Democratic votes in the Senate, aiming at a filibuster-proof 60 that would allow his tax cuts to be permanent.

And still the secret nuclear option is the threat to abolish the deduction on state and local taxes (see [“Trump's Tax Cut Nuclear Option”](#) May 1, 2017). In the end-game, we believe Democrats will have no choice but to bend to Trump's will in order to preserve the largest deduction in the tax code, which primarily benefits wealthy taxpayers in blue states.

- We note that the mainstream media, after months of careful silence, has begun over the last week to [run stories about it](#), including [some aimed at scaring Republicans in blue states](#).
- Now, in reaction to yesterday's framework, Democrats have broken cover and started to strongly complain about it. [Senator Diane Feinstein \(D-CA\) said](#), elimination of the state and local tax deduction makes the GOP plan a “non-starter” because “I don't believe California should suffer in order for President Trump to give tax cuts to the rich.”
- Love him or hate him, it must be acknowledged that his daring gambit to eliminate this primarily blue state deduction is brilliant. Look how he's gotten inside Feinstein's head – he's got her saying that he can't take away tax cuts for the rich because it would give tax cuts to the rich. Checkmate.

The great question for investors is the extent to which tax cuts are already priced in markets. We have argued all year that, in an atmosphere of constant apparent chaos, [markets have been assigning a very low probability to meaningful tax cuts](#) (see, among many, [“Debt! NoKo! Irma! DACA! Cohn! ...and Other 4-letter Words”](#) September 7, 2017). [We think this is starting to change.](#)

- It's significant that yesterday's “framework” really had no more detail than prior plan-documents -- yet this time there has been no derision that the mere outline is [“laughable”](#) or [“embarrassing.”](#) as there was when National Economics Council Director Gary Cohn and Treasury Secretary Steve Mnuchin rolled out their [one-page term-sheet](#) in April (again, see [“On Trump's Tax Cut Proposal”](#) April 26, 2017). [No, this time it's being taken seriously.](#)
- Talking to clients every day about this, we still think the balance of consensus is that nothing will get done. But the balance is beginning to shift, with more and more minds opening up to the possibility that something might just get done.
- Getting anything like the proposed tax cuts done would be very positive for growths, positive for stocks, and positive for higher long-term bond yields – by first-order effects through the

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enhancement of after-tax business earnings, and by second- and third-order effects arising from an overall positive supply-side shock. But expectations are queued up now so that if nothing happens, there will be some disappointment but not much. The surprises here remain on the upside.

Bottom line

Yesterday's GOP "unified framework" for tax cuts is another skeletal document, very light on specifics. In almost all ways it is Trump's vision – it is just what he campaigned on, and it shows his growing mastery that the fractious GOP is making a self-conscious show of being "unified" behind it. Trump has taken his barnstorming tour to a third red state with a vulnerable Democratic senator, and the threat of eliminating the deduction on state and local taxes remains a nuclear option for the end-game, to secure Democratic votes in the Senate. We think markets are moving a little toward believing that tax cuts are possible. As proposed, these tax cuts would be a powerful supply-side shock, leading to faster growth, upside for stocks, and higher bond-yields. ▶