September 13, 2017

Why Tax Cuts Will Happen II

We disagree with assessments that view the Trump Administration as too incompetent to implement tax cuts by year-end. If anything, since the departure of Reince Priebus and the appointment of John Kelly as Chief of Staff, the leaks have died down and a steady competence within the Administration is beginning to emerge.

Almost two weeks ago President Trump's approval ratings were at 39%, where they were on Election Day. Two hurricanes later and with the President demonstrating a proactive, hands-on stance throughout, those numbers have risen to 46%. We expect to see those numbers improve even more as our thesis (tax cuts by year-end) plays out.

Importantly, the tax cut effort has been left to the Administration's most capable hands. Treasury Secretary Steven Mnuchin has been flawless in advancing the pro-growth case. He privately prevailed in getting Paul Ryan and Kevin Brady to abandon their plans for a border-adjusted cash flow tax, and he has correctly defended capital gains tax reductions as a critical lever to increase investment back into the economy. During Congressional hearings and public press conferences, Mnuchin's demeanor is professional – calm, unflappable, steady – as he advances the administration's case for robust tax cuts. Meanwhile, former House Freedom Caucus leader, OMB Director Mick Mulvaney, stands out as one ready to successfully argue for a pro-growth package even within the ostensible parameters of "revenue neutrality" and certainly outside of it.

Aside from its leadership (i.e. Paul Ryan), we view the House as pro-Trump territory when it comes to tax reform. House Freedom Caucus leaders Mark Meadows and Jim Jordan, who are viewed by those out-of-the-know as die-hard austerians, are willing to ditch revenue neutrality and allow for a tax cut package that sees the deficit increase at the outset. This is because they understand true, pro-growth tax cuts induce risk-taking and accelerate economic growth, which will increase tax revenues and thereby improve the federal debt outlook.

The real challenge has always been with the Senate. But we are not too concerned. If the "Skinny Repeal" amendment on Obamacare failed by one vote, we are 100% sure tax cuts will succeed in the Senate before year-end.

President Trump continues to use the bully pulpit (Twitter, rallies, speeches) and the office of the Presidency to drive the issue down the field. Yesterday, for instance, he hosted a bipartisan dinner that included three non-Republican Red State senators -- Donnelly (I-IN), Manchin (D-WV), and Heitkamp (D-ND) along with Republicans Hatch, Toomey and Thune. Afterwards, Manchin seemed quite pleased and issued the following statement: "I look forward to working with the President, the Administration and my Senate colleagues on both sides of the aisle on tax reform and going through regular order so we can help all Americans and West Virginians prosper."

The probability is high for more than one Democratic crossover, meaning another type of McCain defection at the last minute on the Republican side is unlikely to derail the current tax cut drive in the Senate. In fact, given the inroads Trump is making with Democrats, we're not willing to rule out a bipartisan, regular order tax cut deal. It's unclear how much wheeling and dealing will be necessary to get a filibuster proof deal, but it's possible to see Steve Bannon's gambit of raising income taxes on those with incomes over $5 million as an amenable exchange for other Democrats to cross the aisle to support dramatic tax reductions on corporations and pass-through entities and eliminating the estate tax, which could unleash trillions in new capital.

Furthermore, striking fear in many inside the Beltway, President Trump will hold every Senator accountable for how they vote on the upcoming tax package.

Thanks to the legislative expertise of Majority Leader McConnell, the debt ceiling issue is reportedly off the table for 2017 and will not to be taken up again until well into 2018. This effectively keeps the legislative focus on tax cuts and accelerating economic growth.

Yesterday, Mnuchin began to delineate who might not benefit from the tax cut reduction on pass-through entities, e.g. accounting firms. Such granularity and specificity is what we should expect from Treasury as we get closer to the drafting of actual legislation.

Dollar bears, and gold and Treasury bulls beware. We believe markets are just beginning to sense that draft legislation will emerge very soon, perhaps even by the end of September. Today, two GOP staffers confirmed that House Ways & Means Chairman Brady will release tax plan details the week of September 25.

Bretton Woods Research