FOREX TRADING

ANALYSING US TAX REFORM

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We believe that sound investment and trading decisions begin with a strong grounding in financial education. Our goal is to make this available to everyone - and this free eBook is part of that commitment.

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CORPORATE TAX CUTS?

FOREWORD

The current focus of President Trump's administration is tax reform. Specifically, they want to cut tax rates for businesses and the middle-class.

This constitutes a dramatic shift in fiscal policy. Significantly cutting taxes would alter the dynamic of the US economy.

The purpose of this eBook is to analyse how cutting taxes could affect the financial markets - and your trading decisions. We hope you find it useful.

Patrick Latchford
CEO, Blackwell Global Investments (UK) Limited

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WHY DO TAX CUTS MATTER?

ATTRACTING INVESTMENT

During the US Presidential Election of 2016, taxation was one of the hot political talking points.

In particular, then presidential candidate Donald Trump promised to reduce the tax burden on American businesses. The logic behind this thinking is easy to follow. The US currently has one of the highest corporate tax rates in the world compared to other developed nations.

The top federal tax rate that can be applied in the US is 35%. This doesn't include state and local taxes. By comparison, the UK has one of the lowest tax rates amongst major economies at 19%.

Clearly, by lowering its corporate tax rates, the US becomes a much more attractive proposition for multinational businesses to invest in.

JOB CREATION

Why does business investment matter? Well, it's actually quite simple - it can boost job creation.

Despite consistently strong job creation figures in the second term of the Obama administration, many citizens in 'Middle America' didn't feel the effects of that data.

It's one of the reasons why Donald Trump won the 2016 election. His promise to fuel significant job creation resonated with a disillusioned electorate.

Rust-belt states such as Michigan favoured a taxation policy that would supposedly give firms more money to hire new workers.

BUT WILL THIS TRANSLATE?

The Trump administration is proposing cutting corporate tax rates down to approximately 15%. This is a huge tax cut.

Surely, this will spark substantial job creation and economic growth? Not exactly. The effects of such a tax cut are difficult to anticipate with any certainty.

In particular, there are two concerns.

The first is the link between low tax rates and job creation. By cutting corporate tax rates, the US government will essentially be letting US businesses keep more of their money. It's then up to those businesses whether they hire more workers.

Of course, there is no guarantee that businesses will do this. Demand drives business growth and job creation - not tax cuts. Having said that, hiring is easier when businesses have more cash, but ‘trickle-down economics’ is a theory widely contested by economists.

Secondly, there’s the issue of fiscal responsibility. To fund these tax cuts, the Trump administration is also cutting government spending. Some economists argue that this will cancel out the benefits of cutting corporate taxes. Remember, public spending has a noticeable impact on the US economy’s output. By reducing public spending, the US government could dampen the demand that drives economic growth.

IMPACT ON THE MARKETS

BIG BUSINESS WILL BENEFIT

Big business clearly stands to benefit from these tax cuts. It's why investors moved their capital away from government bonds into private equities following the election of Donald Trump.

If tax cut proposals get through the House and Senate, traders should expect noticeable market reactions.

THE US DOLLAR

A low corporate tax rate will boost foreign direct investment into the US. Investors are always looking for favourable conditions to make business investments. With a rate of 15%, many investors will want to move their capital into the US marketplace.

This - in combination with the likely rate hike in December 2017 - will act to strengthen the US dollar. Let's explore why this might happen. Foreign direct investment can drive the value of a currency by increasing its demand. Therefore, the currency's value increases.

STOCKS

Throughout 2017, the US stock market has continued to break records. Investors are encouraged by the US economy's steady growth - and excited about the pro-business policies that could be introduced by the Trump administration. A corporate tax cut could add to this momentum.

WILL TAX CUTS HAPPEN?

Traders need to carefully monitor US politics. The Trump administration has so far struggled to pass any of its campaign pledges into law.

An example of this was the failed attempt to introduce the American Health Care Act in 2017. The White House simply did not have sufficient political support to get the bill passed by the Senate.

Let's be clear - Capitol Hill remains deeply partisan. Some Republicans are also less than enthusiastic about Donald Trump's presidency.

Furthermore, the Trump administration has another pressing issue on the agenda. Two of Trump's election campaign team have now been charged as a result of the investigation led by special counsel Robert Mueller. This is the investigation that is looking into potential collusion between the Trump campaign and Russia, in an attempt to influence the US election.

This investigation continues to be a distraction for The White House - and could make it more difficult for the administration to pass legislation.

We recommend that traders closely monitor the news to follow developments in Washington. This will provide clues as to if and when tax reform will be passed.


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Founded in 2010, Blackwell Global was established to offer brokerage solutions for private and institutional clients. Blackwell Global is a Straight Through Processing or STP broker who provide their clients with superior liquidity and price feeds from top international banks. These are offered alongside 24-hour technical support, market research tools, educational materials, professional partnership programmes and fully integrated trading platforms.

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