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'This newsletter is translated from the Japanese edition distributed on December 22nd.
Center for Risk Management Strategy at Deloitte Touche Tohmatsu LLC.

Global Risk Watch Newsletter

U.S. tax cut – what it means for the economy, etc.

Global Risk Watch Vol.33
28 December 2017

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1. Overview Macroeconomic and Financial Risks (Trends & Topics)

 # U.S. tax cut – what it means for the economy (Tsuyoshi Oyama, Partner/Head of Center for Risk Management Strategy (CRMS) at Deloitte Touche Tohmatsu LLC/Deloitte Asia Pacific Risk and Capital Management Leader)

The Stock prices continue to rise to new heights thanks to calm consumer prices and interest rates as well as a booming global economy. 3Q GDP growth was revised up in the US and Japan, confirming perfect economic conditions in many developed countries. These perfect conditions seem to be kept up to now being supported by current robust external demand and investment in Japan and Europe, and high levels of consumption and investment in the US. At once, we have seen no signs that prices are about to rise, laying the foundation for already historically high stock prices to rise even further.

In opposition to the above, a conspicuous sense of nervousness abounds in the market partly owing to the instability of US politics and heightened geopolitical risk, causing sporadic temporally price falls. As well, while the Chinese economy continues to show strong growth, a coherent pattern of growth deceleration has continued. All eyes now turn with some trepidation to the further enhanced Chinese adjustment policy rollout that is sure to follow on the heels of the conclusion of the Communist Party Congress. As a result, long-term interest rates tend to rise and stock prices in turn fall.

In this environment, the news that large-scale tax reform in the US, represented by a huge cut to the corporate effective tax rate, could be passed before Christmas is thrust into a larger context. For the Trump administration, passing tax reforms marks the first successful major achievement of their policy goals. The largest tax cuts in US history are certainly expected to affect the country's economy one way or the other. That is to say, there is no consensus on whether or not these tax rates will actually be able to unlock potential growth in the US economy.

American firms as like Japanese firms are currently enjoying robust earnings, which are just being internally stockpiled, rather than directed towards wage increases or investments. There prevailing opinion is that that when companies receive this tax break, rather than sparking new investments or pushing up wages, the windfall will instead be passed on to shareholders through increased dividends or stock buy-backs. In the short term this certainly spells higher stock prices, but there will be no wage increase, or productivity gains which support a sustainable growth in the mid to long term. In stronger terms, such actions will most likely serve to enrich those wealthy enough to own stock and leave the middle class to divvy up what remains.

Thinking back, President Trump betrayed all expectations and won the 2016 election thanks in large part to the strong support of mainly white Mid-western voters who felt left behind by the post-crisis economic recovery. There is a certain irony therefore in the Trump administration now enacting policies that, rather than close the gap between the rich and the poor, serve instead to expand it. The US is not the only country where voters infuriated by the expanding gap between the rich and the poor caused electoral mayhem. This trend has certainly pushed new as well as existing governments to seek for extreme populist policies. However, the current policy to protect high stock prices will inevitably widen wealth disparity in all these countries. While it may seem that the mutinous electorate is for the moment calm, the risk that in the near future things may turn even more extreme is in fact probably quite large.
