We do not expect a very positive impact from the recently approved Republican fiscal plan

December 21, 2017

www.banorte.com
www.ixe.com.mx
@analisis_fundam

Gabriel Casillas
Chief Economist and Head of Research
gabriel.casillas@banorte.com

Delia Paredes
Executive Director of Economic Analysis
delia.paredes@banorte.com

Katia Goya
Senior, Global Economist
katia.goya@banorte.com

Juan Carlos García
Global Economist
juan.garcia.viejo@banorte.com

- **US Congress finally approved the fiscal plan, with the support of the Republican party**
- **It will now pass to the White House for President Trump's signature**
- **Among the most relevant issues included in the reform is the reduction of the corporate tax rate to 21% from 35%**
- **There will also be a temporary reduction in household income taxes**
- **While the reform seems to be a victory for President Trump, according to a survey conducted by CNN, only 33% of the population supports the outcome achieved, with possible implications for the Republican party in November mid-term election**
- **In our opinion, the reform will not boost economic growth in the U.S. given that the economy is already at full employment**
- **We believe that it is more likely that the reform translates into inflationary pressures, which is why we maintain our expectation of three Fed funds rate hikes in 2018**
- **Regarding the implications for Mexico, we consider that this does not cause a fiscal emergency in our country, since there will be no capital outflows or a physical relocation of companies**
- **Meanwhile, the possibility of a shutdown remains on the table, although the current continuing resolution -which expires on Friday-, could be extended until January 19**

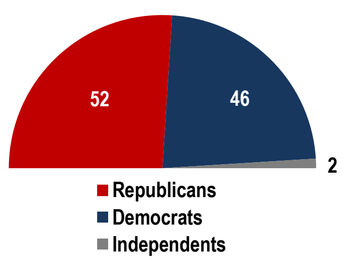
Republican victory in the approval of the fiscal plan. The House of Representatives approved the fiscal plan with 227 votes in favor and 203 against (all Democrats and 12 Republicans). The Senate also approved the plan with a small margin of 51 votes in favor and 48 against. However, the proposal was approved again in the House of Representatives, after the Democratic senators pushed three small modifications to the plan. The next step is the signature of President Trump.

The most relevant aspect of the reform is the reduction to the corporate tax from 35% to 21%. Among the most relevant issues of the approved reform is the reduction of the corporate tax rate to 21% from 35% on a permanent basis (the initial proposal of both the House of Representatives and the Senate assumed a reduction at a rate of 20%). With this, the US corporate tax rate will be in line with the average in other advanced economies, which is 22.5%.

There will also be a reduction in household income taxes, but it will be temporary, expiring in 2025. Seven brackets will be maintained but 5 of them will have reductions in the rate level. The rates applied are 10%, 12%, 22%, 24%, 32%, 35% and 37%. It is estimated that, on average, this reduction will lead to an increase in personal income of 2.2%. However, the increase of 3.3% for individuals with incomes above US$1,000,000 per year contrasts with the increase of only 1.6% in the range of US$50,000 to US$75,000 per year. Given the temporary nature of these reductions, it is expected that by 2027, households with incomes of less than US$75,000 per year will see considerable increases in their tax payments. Moreover, the plan also includes a restructuring of the deduction system. In addition, the mandate under *Obamacare* to maintain health insurance will expire in 2019. From that year on, there will no longer be a penalty for not having said insurance. It is estimated that the deficit that will result from the reform will be US$1.5trn over 10 years.

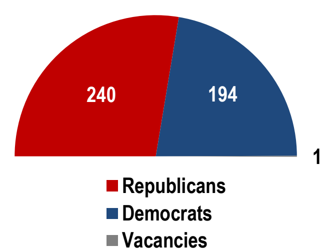
The approval of the reform is not necessarily a victory for Trump. While the reform seems to be a victory for President Trump, according to a survey conducted by CNN, only 33% of the population supports the reform, while 66% consider that it benefits the upper-class more than the middle and lower-classes. This raises the question on whether the approval of the tax plan will benefit the Republicans in November's midterm elections, since corporate tax cuts do not usually generate more popularity among voters. Recall that in November 2018, 33 seats will be renewed in the Senate: 23 are in the hands of the Democrats, 2 independents –which usually vote in line with Democrats- and 8 Republicans along with the House of Representatives.

Current composition in the Senate
Seats



Source: US Senate

Current composition in the House of Representatives
Seats



Source: US House of Representatives

*Note: As of January 1st, 2018 Republicans will lose a seat in the Senate won by Democrats after the election in Alabama.

We believe that the impact of the reform on growth will be lower than expected and could derive in inflationary pressures. In our opinion, the approval of the reform will not boost economic growth in the US as much as expected, because the economy is already at full employment. It is more likely that it translates into inflationary pressures, which is undoubtedly one of the factors that the Fed will consider in its monetary policy decision making process. In this context, we maintain our expectation of three Fed funds rate hikes in 2018.

Tax cut in the US is not a reason for a fiscal emergency in Mexico. We reiterate our concern about the reform as we expect that it will generate more inflationary pressures than economic growth, making the Fed more aggressive in its process of normalization of monetary policy. This could have an impact not only at a global level but also in Mexico, even though Banxico has been much more aggressive in restricting monetary policy since December 2015. Regarding the implications for the Mexican economy, we highlight four of them: (1) It will not cause capital outflows of a financial nature because there is no fiscal discrepancy between the tax rates of Mexico and other countries, including the US with an income rate of 21%. Many types of funds (such as pensions) and assets are exempted from withholding or payment of income tax and those that are not exempted face a withholding rate between 4.9% and 15% (<21%), as shown in the table below; (2) it will not cause physical relocation of the companies; although, in the short-term (3) they could generate lower tax revenues for the Ministry of Finance, given the loss of fiscal advantage vs. US; and (4) in the medium term the incentives to invest in Mexico could decrease probably inducing a new fiscal overhaul. Nevertheless, even though we believe that this last effect could be marginal, it will have to be evaluated soon.

Tax rates paid by foreign investors

Item	Withholding tax
Federal Government and Banxico's bonds, credit and other instruments	Exempted
Pension funds	Exempted
Export credits maturing above 3-years	Exempted
Investment banking and savings	4.9%
Credit titles	4.9%
Credit facilities, stocks and futures	In Mexico's income tax code: 10%, but under US-Mexico income tax treaty 4.9%
Payments to reinsurers	In Mexico's income tax code: 10%, but under US-Mexico income tax treaty 4.9%
Financial leasing	15%

Source: US-Mexico income tax treaty of 1994

The possibility of a shutdown is still on the table. The current continuing resolution could be extended to January 19, proposal that could be voted in the next few days. Initially there was talk of voting on the issue of government funding along with defense spending proposals and the allocation of US$81bn in aid for natural disasters, but controversy over these last two issues is preventing said proposal to pass in the Senate, where 60 votes are required for its approval, implying that the support of the Democrats is required. In our opinion, the proposal to extend the CR until January 19 will be approved, in order to avert a partial government shutdown.

GRUPO FINANCIERO BANORTE S.A.B. de C.V.

Research and Strategy

Gabriel Casillas Olvera	Chief Economist and Head of Research	gabriel.casillas@banorte.com	(55) 4433 - 4695
Raquel Vázquez Godinez	Assistant	raquel.vazquez@banorte.com	(55) 1670 - 2967

Economic Analysis

Delia María Paredes Mier	Executive Director of Economic Analysis	delia.paredes@banorte.com	(55) 5268 - 1694
Alejandro Cervantes Llamas	Senior Economist, Mexico	alejandro.cervantes@banorte.com	(55) 1670 - 2972
Katia Celina Goya Ostos	Senior, Global Economist	katia.goya@banorte.com	(55) 1670 - 1821
Miguel Alejandro Calvo Domínguez	Economist, Regional & Sectorial	miguel.calvo@banorte.com	(55) 1670 - 2220
Juan Carlos García Viejo	Economist, International	juan.garcia.viejo@banorte.com	(55) 1670 - 2252
Francisco José Flores Serrano	Economist, Mexico	francisco.flores.serrano@banorte.com	(55) 1670 - 2957
Lourdes Calvo Fernández	Analyst (Edition)	lourdes.calvo@banorte.com	(55) 1103 - 4000 x 2611

Fixed income and FX Strategy

Alejandro Padilla Santana	Head Strategist – Fixed income and FX	alejandro.padilla@banorte.com	(55) 1103 - 4043
Juan Carlos Alderete Macal, CFA	FX Senior Strategist	juan.alderete.macal@banorte.com	(55) 1103 - 4046
Santiago Leal Singer	Strategist Fixed income and FX	santiago.leal@banorte.com	(55) 1670 - 2144

Equity Strategy

Manuel Jiménez Zaldivar	Director Equity Research — Telecommunications / Media	manuel.jimenez@banorte.com	(55) 5268 - 1671
Victor Hugo Cortes Castro	Technical Analysis	victorh.cortes@banorte.com	(55) 1670 - 1800
Marissa Garza Ostos	Equity Research – Conglomerates / Financials/ Mining / Petrochemicals	marissa.garza@banorte.com	(55) 1670 - 1719
José Itzamna Espitia Hernández	Equity Research – Airlines / Airports / Cement / Infrastructure / REITs	jose.espitia@banorte.com	(55) 1670 - 2249
Valentín III Mendoza Balderas	Equity Research – Auto Parts/ Consumer Discretionary / Real Estate / Retail	valentin.mendoza@banorte.com	(55) 1670 - 2250
Itzel Martínez Rojas	Analyst	itzel.martinez.rojas@banorte.com	(55) 1670 - 2251

Corporate Debt

Tania Abdul Massih Jacobo	Director Corporate Debt	tania.abdul@banorte.com	(55) 5268 - 1672
Hugo Armando Gómez Solís	Senior, Corporate Debt	hugoa.gomez@banorte.com	(55) 1670 - 2247
Gerardo Daniel Valle Trujillo	Analyst, Corporate Debt	gerardo.valle.trujillo@banorte.com	(55) 1670 - 2248

Wholesale Banking

Armando Rodal Espinosa	Head of Wholesale Banking	armando.rodal@banorte.com	(55) 1670 - 1889
Alejandro Eric Faesi Puente	Head of Global Markets and Institutional Sales	alejandro.faesi@banorte.com	(55) 5268 - 1640
Alejandro Aguilar Ceballos	Head of Asset Management	alejandro.aguilar.ceballos@banorte.com	(55) 5268 - 9996
Arturo Monroy Ballesteros	Head of Investment Banking and Structured Finance	arturo.monroy.ballesteros@banorte.com	(55) 5004 - 1002
Gerardo Zamora Nanez	Head of Transactional Banking, Leasing and Factoring	gerardo.zamora@banorte.com	(81) 8318 - 5071
Jorge de la Vega Grajales	Head of Government Banking	jorge.delavega@banorte.com	(55) 5004 - 5121
Luis Pietrini Sheridan	Head of Private Banking	luis.pietrini@banorte.com	(55) 5004 - 1453
René Gerardo Pimentel Ibarrola	Head of Asset Management	pimentelr@banorte.com	(55) 5268 - 9004
Ricardo Velázquez Rodríguez	Head of International Banking	rvelazquez@banorte.com	(55) 5004 - 5279
Víctor Antonio Roldan Ferrer	Head of Corporate Banking	victor.roldan.ferrer@banorte.com	(55) 5004 - 1454