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Article

FX: Don’t get carried away by US tax talk

Odds of a Trump tax bill by mid-2018 are trivially low

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Dollar prospects

We said yesterday we weren't going to hold our breath when it came to the Republican Party's ‘Big Six’ tax plan – and it's a good job we didn't. What was meant to be a “*very comprehensive report*” was thin on the key details that US markets crave to make any meaningful assessment of the likelihood of a Trump tax plan being successfully signed into law and its overall economic impact. In a strange way, the obscurity is helping to lift long-dated US yields and the USD – and one could see how ‘tax cut talk’ might act as a supporting factor for both in the near-term.

> Our message for investors is not to get carried away

For all the hype over tax reforms this week, the release hasn’t added to what we already knew. The GOP plan sees corporate tax rates lowered to 20% (small businesses taxed at 25%), the individual tax code simplified to three brackets (top rate lowered to 35%) and some element of a repatriation holiday that allows overseas earnings held by US multinationals to be brought back onshore (though the details here are vague)

The bottom line is that the GOP tax plan release don't tick our two basic trading principles outlined yesterday. The lack of credible revenue-raising measures, the focus on tax cuts and not reforms, as well as the somewhat regressive nature of the policies, suggest that odds of a Trump tax bill landing on the President's desk in the next 6-12 months still remain relatively low. We still prefer to view the dollar as being in correction mode – rather than the start of a fundamentally-driven move higher. Fading this is our preferred tactic, especially versus currencies where the domestic story remains constructive. In the G10 FX space, buying GBP/USD on dips looks attractive – especially with Carney and Broadbent set to speak in the next few days (both of whom may talk up prospects of a November BoE hike).

Euro prospects

Watch out for the 1.17 support level in EUR/USD. While the US dollar remains in “correction mode”, negative sentiment around eurozone politics continues to weigh on the EUR. German CPI data today will be watched ahead of the EZ release tomorrow. Any negative surprises could see EUR/USD clear the key 1.17 support level, and risk a more pronounced move to 1.15-1.16

NZD: Divergence between Australia and New Zealand

The Reserve Bank of New Zealand held rates at a record low early and its statement continued to refer to policy remaining accommodative for a "considerable period". The official projection shows rates on hold into 2019. That seems too long. What does look more likely, and backed up by market futures, is that the Reserve Bank of Australia will likely raise rates before the RBNZ – which raises some longer run questions about the recent AUD/NZD weakness. Risks for a move to 1.10.

MXN: Banxico meeting a non-event

The Bank of Mexico meet today but ING's Gustavo Rangel is looking for policy to remain on hold (7%) ahead of July-18 Presidential election. With the third round of NAFTA negotiations concluding yesterday, the hope remains that swift progress will see talks completed by 1Q18. However, the lack of clarity on the US administration's proposals makes it hard to gauge if a compromise solution is truly within reach. In general, less supportive peso drivers could see USD/MXN at 18.50 fairly soon.