Markets appear in steady mode these days. Most markets are taking a breather after run-ups late last year, especially following the Trump election in November. The leading markets seem to be in trading ranges now or just stalled near highs, awaiting some catalyst event or a change in economic conditions. We are still up 6-7% ytd on US equities, and close to 10-11% on European and emerging market stocks; GCC markets are lagging, pressured in part by struggling oil prices. Interest rates are still up on the year (US 10-year at 2.3%) but off their recent highs seen after the December 2016 Fed hike. The dollar, too, had a run-up in 2016, but is now actually down on the year against the major currencies (EUR, JPY), even more now after the French election of pro-EU president Macron.

What gives? Not much. Realism set in regarding the ability to pass (quickly) massive legislation in the US and fears of populists coming to power in the EU receded. On the Trump agenda, good and (equity) positive things are still expected: the awaited significant deregulation is occurring (energy, finance), the feared trade wars are not happening; but the wild balloon of massive and immediate tax reform, which pushed the Dow Jones Industrials Index over 21,000 earlier, lost some of its buoyancy for a time.

In Europe, the populists are still popular, along with the Euroskeptics. The Dutch and French populists (Wilders and Le Pen and others) did well in their elections, but not well enough to reach power and thus scare the markets. We therefore saw the euro gaining ground and EU interest rates rise a bit as risk-off trades were unwound. Meanwhile, concerns about Syria and North Korea, which had popped up on the radar screen, remain thankfully contained for the time being.

On economic performance, the major economies have spewed soothing data primarily, more or less in line with moderate growth, as per say the IMF’s recent update for world growth of 3.5%. Noticeably, the IMF’s April report included an upward revision (a slight 0.1%) to that number. Upward revisions are significant after years of consistent downward revisions at every turn. The change in direction basically means that surprises are finally coming in on the upside, usually a bullish indicator. This view is widely shared, though the assessments of the risks vary somewhat, especially regarding politics and central bank policies (potential end of QE in the EU next year, Fed reducing its balance sheet…).

The focus is now again on the US, where Trump and the Republicans are trying to pass radical tax reform in a very contentious political environment. There are also difficult issues related to “paying” for those tax cuts, in other words the deficit/debt implications. The broad lines of tax reform are: a reduction in the corporate tax rate from 35% to 15%, a tax simplification and tax cut for individuals whereby most deductions would disappear, the standard deduction would double, and tax brackets would go from seven (with
the top one taxed at 40%) to only three brackets taxed: 15, 25, and 35%.

How much of the US tax plan is realized, and its actual timing will have significant bearing on the US outlook. The current 2.0% or 2.0%-plus view for 2017-2018 would start moving up if President Trump gets most of his tax plan, moving closer to 3.0% but not much higher in the near term. One concern, which we share, is that the financial markets are a bit overly optimistic as to content and timing of the proposed tax plan.

In Europe, markets are breathing easier, and now sigh in relief after the French election of centrist Macron for president. Though heavily favored before the election, the markets wanted to see the actual results of the election, having been burnt by Brexit and Trump before. The euro and European equities ran up a bit following the results.

Macron is of course pro-EU and for free trade but is more nuanced as he is seeking some protections for Europe’s trade with outside partners. His positions are not very clear at this point, and his newly formed party has zero MPs in parliament. So, he will have to rely on the upcoming June election to broaden his mandate and/or work with the mainstream parties to be able to govern. Macron’s election, though not market-disruptive, will still yield policy and implementation questions ahead, though not of the Frexit kind.

In the meantime, Brexit negotiations are starting between the UK and the EU, and PM Theresa May has called a June election, which is likely to increase her working majority in parliament from 17 seats to perhaps 100. A stronger government and PM were viewed positively for the GBP because they would strengthen the PM’s hand and potentially move things in surer fashion; but, they could also perhaps result in a middle-of-the-road Brexit as the PM could more easily placate her hard-liners.

The Fed just ended its May meeting with no change to policy, US rates are expected to rise in June and December of this year, as data remains in line with the Fed’s moderate outlook view. Recent Q1 GDP data was weaker than expected at 0.7% (q/q ann.) while the April nonfarm payroll report showed a strong 211K new jobs. These numbers do not derail things, however, as GDP was distorted by one-time factors. GDP growth is still running at 1.9% y/y, the underlying pace in our view. Furthermore, other data, such as PMIs, home sales, and sentiment indicators are all pointing to a steady moderate outlook.

Upcoming US rate hikes will of course have repercussions for GCC interest rates, where currencies are tied to the USD and where oil prices are also keenly watched. The latter have been steady in a range under $55 pb (Brent) before slipping under $50 recently. Talk of extending the OPEC-non-OPEC production cut agreement to the second half of this year is supporting prices, while reports of rising US production and of high inventory levels are pressuring prices lower. Therefore, the GCC countries are plowing along with reforms and consolidation, while their finances are looking somewhat better with the higher oil prices this year. That is easing some of the pressure on fiscality and liquidity. At the same time, most countries are carrying on with their debt issuance programs (domestic and international), the latest being Kuwait’s successful issuance of an $8 billion international bond (5 and 10-year maturities).
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