US markets start pricing a tougher road for Trump economic agenda; Fitch downgrades Saudi Arabia

**Summary**

US politics and the US legislative process finally caught up with markets last week. Some (overdue) adjustment finally weighed in, primarily on the USD and US equities. According to the broad consensus of late 2016, the USD was supposed to rise in 2017, at least in the first part of the year. That view was based on three arguments:

- The stronger US economy would imply a still tighter Fed policy stance, certainly relative to the Eurozone (and other countries).
- Trump’s economic agenda would further pump up the US economy.
- Political and election risk in Europe would weigh on the euro and help the USD.

The three factors remain in play but appear to have already been largely priced in. Furthermore, expectations are turning less supportive of the USD in all three cases. EU economic numbers are relatively solid, and the days of aggressive ECB easing action may be numbered. The agenda of Donald Trump and the Republicans is indeed in the pipeline but the rosy view of things unfolding smoothly and on time has met reality: Congressional votes have to be rounded; different views and factions need to be satisfied, parliamentary rules get in the way, etc. This is especially obvious after the first attempt at legislation (reforming Obamacare) by the new administration/Congress was unable to get through over the weekend.

Finally, point-3 above was deflated by the Dutch election that saw the far-right underperform expectations, and by French polls supporting the mainstream candidates, so far, for the April presidential election.

So, the USD, which always had an extremely difficult time breaking the 1.05 level to the euro, was trading above 1.08 late in the week (euro up 3% ytd). Similarly, the JPY had a good week, trading near 111, or up 5.5% ytd. Many analysts revised their USD numbers lower for 2017. The Kuwaiti dinar, which is pegged to a basket of currencies, moved up, closing at 3.28 USD (or 0.3046 KWD/USD), its best level since November 2016. The Kuwaiti dinar, which is pegged to a basket of currencies, moved up, closing at 3.28 USD (or 0.3046 KWD/USD), its best level since November 2016.

**International macroeconomics**

**USA:** Interest rates, equities and the USD all corrected a bit last week, in large part driven by more realistic expectations for the Trump economic and tax agenda. Mr. Trump and the Republicans (with for now zero help from the Democrats) were intent on, in that order: repealing and replacing Obamacare, cutting taxes, and pushing infrastructure spending. The first part has now been postponed, or scrapped, for lack of sufficient votes. This should further weigh on expectations ahead. The US House of Representatives’ failure to pass the American Health Care Act last Friday (ACHA, to replace Obamacare) was seen as a crucial first test of Mr. Trump’s leadership in Washington and of his influence on his own party. Markets will thus turn more cautious in their anticipation of the other expected “goodies” (tax cuts, infrastructure spending) down the road.

**Eurozone:** Emmanuel Macron, the centrist candidate for the French presidency, emerged as the favorite to win the April election after the first
televised debate. Recent polls show Macron leading, ahead of far-right candidate Marine Le Pen. The debate outcome helped soothe worries over the rise of anti-establishment voices in France and the EU in general and was a plus for the euro.

Eurozone flash PMI estimates revealed continued healthy growth momentum. The composite Eurozone PMI registered at 56.7 in March (56.0 in February) and averaged 55.7 in Q1, the highest in six years. (Chart 1.) Growth was observed in both services and manufacturing, and was driven by a strong expansion in Germany and France.

UK: Inflation increased to 2.3% in February, topping the Bank of England’s (BoE) 2.0% inflation target for the first time since November 2013. (Chart 2.) The core CPI index, which strips out food and energy, also rose to 2.0%. The big 0.7% m/m increase sent the pound up almost 1% against the dollar, to a 3-week high of $1.248. Transport and food, along with the exchange rate-sensitive culture and recreation components of the CPI, were the largest contributors to the spike in inflation.

Japan: February exports grew at their fastest pace in over two years, helped by the timing of the Lunar New Year, which led to a boost in Chinese demand. Exports rose by 11.3% y/y, while imports slowed to a mere 1.2% y/y on the back of continued weakness in consumer demand. The trade surplus widened to a multi-year high of $7.2 billion. (Chart 3.)

**GCC & regional macroeconomics**

**Kuwait:** The real estate market got off to a slow start in 2017, with February sales decreasing by 40% y/y to KD 155 million on the back of weakness in the commercial and investment sectors. Meanwhile, prices continued to show signs of stabilization, as reflected in NBK’s indices, suggesting that an end to a two-year correction may be at hand. (Chart 4)

With just a week left to the deadline, 65% of Kuwaiti listed companies have announced results for 2016. Profits were up 3.1% y/y with growth led by banks, which saw profits up 5.5% y/y. Excluding banks, profits were up a mere 0.5% y/y.

**Saudi Arabia:** Fitch downgraded the Saudi sovereign rating by one notch to A-, citing a larger-than-expected budget deficit in 2016 (17.3% of GDP) and concerns over the ability to implement ambitious reforms. The downgrade, its second since oil prices began to slide in 2014, brings its Saudi rating into line with Moody’s, but remains two notches above S&P’s.

Inflation ticked up slightly to -0.1% in February. (Chart 5.) The kingdom’s cost of living index was still in deflation territory, however, with the largest component, food and beverages, down -3.4% y/y. Transportation costs were also down by -2.7% y/y, although this is largely a base effect stemming from last year’s domestic fuel price hikes.

**Qatar:** The liquidity crunch that was a prominent feature of the Qatari banking sector in 2016 appears to be easing. Deposits increased by almost 20% y/y in February thanks to non-resident deposits, which have doubled over the last year. A Fitch report raises concerns that this is being driven mostly by depositors from Asia seeking higher returns, which is increasing funding costs and increasing dependence on foreign liabilities. (Chart 6)

**Egypt:** The budget deficit narrowed during the second half of 2016 to an estimated 11.4% of GDP (vs. 12.6% in 2H15) as wage and subsidy bill growth came under control. The wage bill contracted by 2.4% y/y during the period, while the cost of subsidies grew by only 1.9% y/y compared to
15% y/y the year before. (Chart 7.)

A stamp tax on capital market transactions will be introduced in May 2017, though its budget impact is likely to be limited. The 0.125% levy will be on all transactions of shares and bonds, including over-the-counter deals. A higher 0.3% rate will be imposed on transactions involving more than a third of a company’s stock. The tax could raise EGP 1-1.5 billion, which accounts for a mere 0.05% of GDP.

**Markets – oil**

Brent crude dipped below $50/bbl last Wednesday for the first time this year after the US’s EIA published weekly data showing that US crude inventories climbed to a fresh record, undermining OPEC’s efforts to unwind the huge overhang of global crude stocks. The consistent increase in US crude inventories—another 5 million barrels were added last week to bring the total to 533 million barrels—hurt prices. As did the relentless rise in shale oil production since July 2016, recovering about 700,000 b/d, or 60% of its ‘lost’ production. These developments brought into question whether OPEC, which has delivered 110% of its output cut target (according to secondary sources), will be able to materially bring down the historically high crude stocks by the end of June. (Chart 8.)
Equities lost ground this week with the MSCI World retreating 1.2%. US equities saw their worst one-day decline since the presidential election and the S&P 500 and DJIA closed the week down 1.4% and 1.5%, respectively. Markets seem to be disheartened by fears of delays to President Trump’s economic agenda. European equities edged lower with the Euro Stoxx 50 declining 0.1%. Emerging markets saw some profit-taking following several weeks of gains and the MSCI EM closed the week down 0.1%. (Chart 9.)

Regional markets, lacking a catalyst of their own, took their cue from international markets and saw another week of declines. Indeed, falling oil prices didn’t help and the MSCI GCC index closed the week down 0.3%. The Dubai and Saudi markets underperformed with their indices down 1.7% and 0.6%, respectively. The two markets tend to be more vulnerable to international markets than their GCC peers. Meanwhile, Kuwait’s price index broke through the “7000” level for the first time since 2014, with the value-weighted index advancing 0.5%. (Chart 10.)

Investors bought into US government bonds as equity markets corrected, as they expected a slower roll out of President Trump’s fiscal stimulus and tax reforms. Last week’s failed attempt at healthcare reform signaled a potentially tougher road for Trump’s political agenda. This saw the US 10-year yield dip to as low as 2.39% during the week from a high of 2.60% in the days that preceded the Fed’s most recent rate hike, before it ended the week at 2.42%.

In Europe, the ECB ended its second targeted longer-term refinancing operations (TLTRO) program without announcing its extension, marking the beginning of a new phase of relatively tighter monetary policy. The ECB will also be reducing its monthly QE bond purchases to €60 billion starting April 2017. Meanwhile, the pro-establishment outcome of the French debate helped move investors into riskier trades. Yet, despite what should have been upward pressure on rates from these developments, yields on 10-year bunds remained low, finishing the week down 2 basis points at 0.40%.

GCC yields on paper maturing in 2021 tracked US Treasuries lower. Yields dropped across most sovereign debt by 4-13 bps. Meanwhile, Kuwait’s 2022 bond traded at 2.72%, down 8 basis points from a week ago, and 16 basis points since its issuance on Tuesday 14 March 2017. (Chart 11.)

In the regional primary market, Saudi Aramco is looking to raise $2 billion in riyal-denominated sukuk. The move is part of a larger plan to raise $10 billion before its planned IPO in 2018. This comes at a time when domestic liquidity conditions have improved, in part as the government refrained from issuing domestic debt in recent months. (Chart 12.)