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ECONOMIC REPORT

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MARKETS OPEN LOWER WITH HISTORIC TRUMP VICTORY; DECEMBER FOMC RATE HIKE LESS LIKELY

SUMMARY

- U.S. stock markets have opened lower after Trump's surprise victory in the U.S. presidential election, although they have come back from larger overnight declines.
- A President Trump is likely to reverse the general bipartisan consensus in favor of free trade and immigration.
- Large personal income tax cuts are likely in the near term, perhaps with corporate tax cuts as well. The U.S. budget deficit is set to increase over the next few years.
- Repeal of the Affordable Care Act is also likely.
- Trump's victory makes an increase in the fed funds rate in December less likely.

U.S. financial markets have recovered somewhat in the aftermath of Donald Trump's surprise victory in the U.S. presidential election. The S&P 500 opened down by about 0.5 percent this morning. Overnight, the futures market indicated a 5 percent decline, triggering a market "circuit breaker" that stopped trading temporarily.

There are many open questions about Trump's economic policies, but they are likely to be very different from the basic bipartisan consensus that has guided U.S. policy since World War II. Trump has been very skeptical of U.S. trade pacts, and has called for severe restrictions on immigration. He also called for large cuts in personal income tax rates for wealthy Americans, a large infrastructure program, a reduction in regulations, and the repeal of the Affordable Care Act. With a Republican Congress, many of his policy proposals are likely to be enacted, particularly large personal income tax cuts and repeal of the ACA. There could also be changes to corporate income taxes that would allow for greater repatriation of profits earned by U.S. companies abroad.

The initial market response was negative. Stock markets are down around the globe, and U.S. stocks have opened down about 0.5 percent from yesterday's close, although they have come back from much bigger losses overnight. The U.S. dollar is now flat against a basket of other major currencies, coming back after falling 2 percent as Trump took the lead in the election. The dollar has strengthened against its two major trading parties. It is up 10 percent against the Mexican peso; the peso fell to its lowest level ever, at more than 20.7 per U.S. dollar, earlier in the morning, and now is at around 20.1 per dollar. The U.S. dollar has also strengthened more than 1 percent against the Canadian dollar, to 1.34 C$/US$. The dollar is roughly flat against the euro and British pound, down against the Japanese yen, and up against the Chinese yuan.

With much greater economic uncertainty likely in the months ahead, the Federal Open Market Committee could decide to hold off on an increase in the fed funds rate; PNC had been expecting the FOMC to raise the rate at its December 13-14 meeting, but that looks much less likely now. As of early Wednesday morning the fed funds futures market is predicting a 71.5 percent probability of a December rate increase, down from 76.3 percent yesterday. The yield on the 10-year Treasury is now at 1.95 percent, up from a close of 1.86 percent on Tuesday. The rate plunged to 1.72 percent overnight, perhaps in a flight to quality, before rising because of expectations of larger budget deficits in the wake of Trump's proposed expansionary fiscal policy, as well as higher inflation expectations. The yield on the 2-year Treasury is down slightly at 0.84 percent from 0.86 percent yesterday, after falling to 0.72 percent overnight, and thus the yield curve has steepened significantly after the election.

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Oil prices fell overnight on growth concerns and the initial decline in the U.S. dollar, but have since made back most of the loss. The price of a barrel of West Texas Intermediate crude is now around $44.84, down about 15 cents from the close yesterday, but up from a low of just above $43 early this morning. Prices for industrial metals have risen on expectations for stronger construction activity.

Gold is up 2.3 percent from yesterday as investors look for safety in the wake of Trump's surprise victory.

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