UPDATE

Knightsbridge Wealth

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The Knightsbridge Wealth magazine for international clients

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Party in the Gulf

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A welcome note from Knightsbridge Wealth

As we go to press, the UK has just completed a lavish three-day jamboree to celebrate the Coronation of King Charles. In recent polling from the opinion poll company You Gov, more than 62% of the population think he will be a "good" King, up from 39% last March.

The King's attempts to reconcile old and new were everywhere in the ceremony, from the "vegan-friendly" oil that was used to anoint him, to his refusal to allow cameras to film the anointing, which he considered to be a moment of connection with God. At the same time, he has previously defined himself as a "defender of faiths" as well as "defender of the faith".

The lavish event – and how different it is from modern Britain – is the essence of its meaning. The British Royal family might offer uncomfortable imperialist echoes and entrenched inequality, but it also offers pomp and ceremony admired the world over. The proportion of Britons who want to abolish the monarchy has risen over the years – from 3% in 1983 to 14% now. Among 18–34 year-olds the figure is over 20%. Hardly the stuff of revolution.

And working royals do work. On a single day in March, Princess Anne visited a stable and an industrial park in Birmingham while Charles went to Hamburg-Dammtor Railway Station in Germany and the "future site of the Green Energy Hub Hamburg" to hear about its "ongoing transition to a carbon-free port".

Mostly, they do so without complaining.

As London and the UK basks in this international attention, we hope a boost to its economy will follow as it must finally build on its vision for an economy outside the European Union.

Meanwhile, China's economy is back in business. The world's second-largest economy is enjoying a reopening boom. GDP expanded by an annual 4.5% in the first quarter. The rebound has been led by consumers, with retail sales surging by 10.6% year on year in March. Even the long-suffering housing market is showing signs of revival.

While consumption roars, manufacturing is struggling. China's manufacturing Purchasing Managers' Index (PMI) fell to 49.2 in April from 51.9 in March (readings below 50 denote a contraction), even as the services PMI registered a robust 56.4. Western shoppers are not buying as many Chinese-made goods as they did during the pandemic. Still, officials in Beijing won't be too worried about the lopsided recovery. They have spent years trying, largely fruitlessly, to rebalance the economy towards services and consumption. It now seems rebalancing has finally happened.

The consumer-led nature of China's recovery means it will have less impact on the rest of the world than in previous upswings. Previous rebounds in China have been decisive for global growth. In 2009 and 2016, for example, significant stimulus focusing on infrastructure led to a rebound in world trade. Yet this time infrastructure spending is likely to slow, which will dampen any rebound in commodities.

Many global fund managers are steering clear of Chinese investments, after seeing wartime sanctions erase the value of Russian investments. The issue is not so much potential returns but whether investors can get their capital back at all in a crisis. Foreign money, particularly from the US, is reluctant to invest.

While some investors see short-term returns in prospect, the long-term outlook is far hazier. Decades-long foreign optimism on China's capital markets is breaking down.

This edition of Update covers some of the main topics of interest to international clients, such as the continuing Boom in the Gulf, and the concerns surrounding the US property market. It has never been more important to get an expert view on your investments, and our team looks forward to working with you throughout 2023.

Our strategic partnership with UBS (Union Bank of Switzerland) gives the best of both worlds – personal service and the ability to react in a way that only a small firm can, partnered by one of the world's most prestigious brands.

The decline and fall of Credit Suisse

It was once Switzerland's biggest bank with a long history and a reputation for stability. Then over the course of a weekend, it was no more – swallowed by a former rival.

After years of scandal, months of customers leaving, and weeks of rumours, Credit Suisse, founded in 1857, is no more. In an emergency deal brokered by the Swiss government, the bank's rival UBS agreed to buy it in an all-share deal for about CHF3bn (£2.6bn). That was a 60% discount to Credit Suisse's market cap, and about 5% of its market value as recently as 2018. Credit Suisse was brought down by a good old-fashioned bank runs: personal and business customers withdrew their cash and investors dumped their shares. Yet there's a case that the panic was unfounded. Unlike Silicon Valley Bank, which collapsed a fortnight before, Credit Suisse had a large and diversified balance sheet and client base, and decent capital and liquidity ratios. And its profitability was no worse than several other European banks, albeit last year it lost around CHF7bn, its worst performance since 2008.

Years of worries over management and governance meant that confidence in its future was low. Investors had lost patience with the ceaseless bad news, and depositors withdrew CHF111bn in the last quarter of 2022. That crisis of confidence deepened just as the market was already spooked by the collapse of Silicon Valley Bank. The Bank's statement, in which Credit Suisse warned over the shakiness of its financial reporting, set the ball rolling. Then the market rout turned into an existential crisis when the bank's main anchor shareholder, Saudi National Bank, ruled out further investment. A promise by the Swiss central bank to provide a $54bn financing backstop failed to prove the lifeline it had hoped. And so, with Switzerland's whole banking sector at risk, the government stepped in, persuading UBS to play the reluctant rescuer.

The long-term causes of Credit Suisse's downfall were excessive complexity and risk-taking – and the seeds were sown decades ago. Back in 1990, the then-CEO, Rainer Gut, saw a chance to take control of the bank's US partner, First Boston, for a modest capital injection and backstopping bad loans. In the 1980s, First Boston had embraced high-yield debt markets and lent billions of dollars to fund risky buyouts. Following the takeover, Credit Suisse embraced the same kinds of high-risk sectors as part of an aggressive growth strategy that involved increased complexity and several poor acquisitions. Lack of leadership was at the core of Credit Suisse's demise. Thomas Bell, a member of the bank's board in the early 2000s, recently said that "No one really knew what all the parts were up to, which led to poor risk management and crisis." It also led to scandal after scandal that progressively destroyed the bank's reputation.

Credit Suisse, as Switzerland's biggest bank for the whole of the 20th century (until UBS merged with Swiss Bank Corporation in 1998), had long had a reputation for stability, and also for protecting the secret fortunes of various dictators, autocrats and other undesirables. But from the 1990s onwards, the cloud of scandal grew. In 1995, it emerged that the bank had operated fake-name accounts for the Philippine dictator Ferdinand Marcos and his wife, Imelda, and stored some of their estimated $5bn-$10bn fortune. In 1999, the bank was fined and its licence revoked in Japan over a "shredding party" where bankers had destroyed evidence to hinder an investigation into whether it was helping companies conceal their losses. In 2000, it was sanctioned for accepting $214m of funds corruptly acquired by the Nigerian dictator Sani Abacha. In 2009, the bank was fined $536m for ignoring US sanctions against countries including Iran, Sudan and Libya between 1995 and 2007.

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Surprisingly, the Bank appeared not to learn the lessons of such a fine. The 2010s saw massive fines for enabling tax evasion in Germany (€150m) and Italy (€109.5m); involvement in various money-laundering scandals in the US, Brazil, Malaysia and Hong Kong; and a corporate espionage scandal in its home city, Zurich.

But all these were dwarfed by the $2.6bn fine it paid in 2014 for helping Americans evade taxes for decades. In 2020, Swiss prosecutors issued a criminal indictment against Credit Suisse for not preventing a Bulgarian drug ring allegedly laundering at least $146m through accounts between 2004 and 2008. The next year brought a triple whammy of humiliations. The bank lost $5.5bn when the US hedge fund Archegos Capital Management collapsed in early 2021. It was forced to suspend $10bn of investors' funds due to the collapse of the supply-chain lender Greensill Capital, whose risky debt Credit Suisse packaged and sold on. And it was fined £350m over its role in the long running "tuna bonds" scandal in Mozambique.

To convince UBS to play saviour, the Swiss state and central bank have had to provide £230bn of emergency liquidity and loans, equivalent to more than a third of the country's GDP. That is dangerous for Swiss banking, the Swiss establishment, and the country as a whole.

It is expected that the new bank will be stronger. The obvious danger is that rushed big deals of this kind have a history of blowing up in dramatic fashion and prove a terrible deal for the acquiring party. A UBS-led takeover was certainly preferable to allowing Credit Suisse to go under. But, to convince UBS to play saviour, the Swiss state and central bank have had to provide £230bn of emergency liquidity and loans, equivalent to more than a third of the country's GDP. That is dangerous for Swiss banking, the Swiss establishment, and the country as a whole.

Zurich's loss is London's gain

When the end came for Credit Suisse, it was very sudden. The bank had been in trouble for years, mired in scandals, and with a management team that seemed to make every mistake possible. With interest rates rising around the world, and depositors fleeing any bank with any question mark over its future, it ran out of both time and money. Even £45bn from the Swiss National Bank was not enough to stabilise it. The game was up. The hastily arranged marriage with UBS was perhaps the best solution. It stopped a messy collapse, and there is at least a slim chance that a stronger bank will emerge from the combination. However, there are two big problems with the deal for Switzerland. London's financial centre should pounce on the opportunity.

The first problem is that it will be hugely expensive. With money flooding out of Credit Suisse, there is no guarantee it will stop there. In the last financial crisis, Iceland and Ireland were effectively bankrupted by their wayward banks and, although Switzerland is a very rich country, Credit Suisse is also a very big bank and there is no guarantee that it won't ultimately meet the same fate.

The second is that it has harmed Zurich's reputation as a financial centre. If you go back 20 years, the city was home to three of the world's major banks. That went down to two following the takeover of Swiss Banking Corporation by UBS. Now, with UBS swallowing up Credit Suisse as well, it will be down to just one, and it is likely that it will take years to integrate the two operations and sort out the mess. Indeed, if the losses are large enough, UBS could well be brought down by it.

Just as significantly, the shareholders have been treated poorly, and the bondholders even worse. The deal was rushed through in a weekend, and Swiss law changed so that there was no need for a shareholder vote on the takeover. Shareholders in Credit Suisse were offered a fraction of what the bank was worth even a few days beforehand, with no time available to explore alternative options. In effect, if you own shares in a Swiss bank, and by extension perhaps in any Swiss company, you don't have any rights at all. You just have to accept whatever the government decides is best. The bondholders were treated even more shabbily, with the holders of convertible bonds wiped out completely, and although that may have been in the small print, bondholders usually rank higher among creditors than shareholders. It is hard to understand why anyone would want to own a bond issued by any Swiss firm again. There are already legal challenges, but they are unlikely to succeed. If necessary the Swiss authorities will simply change the law again to protect themselves.

When the end came for Credit Suisse, it was very sudden. The bank had been in trouble for years, mired in scandals, and with a management team that seemed to make every mistake possible.

Huge damage has been done to Zurich's reputation. In the competition for financial services, one of the world's most important industries, that matters. In the global rankings, Zurich ranked sixth as a finance hub, ahead of Paris and Tokyo. It has always been a major hub for banking, fund management and bond issues. Who will benefit from Zurich's current woes? London could most of all.

We could use insurance to offer an improved deposit-protection scheme so that money could be parked in London without worrying about whether it would be refunded if the bank ran into trouble. We could improve the legal protection of bondholders so they could not suddenly be wiped out while shareholders were looked after. We could keep on cutting back on red tape so that City firms can still innovate to serve new customers.

In lots of ways Zurich was a key rival to the City of London precisely because it was very similar. Switzerland had a small domestic economy, its own currency, and was nimble, flexible and bold, always prepared to try out new products and create new markets. This episode has ruined its reputation, and it is not likely to get it back. A lot of that business will naturally migrate to London as the closest alternative – but if the City makes an effort it could win almost all of it.

The UK's big post-Brexit trade deal

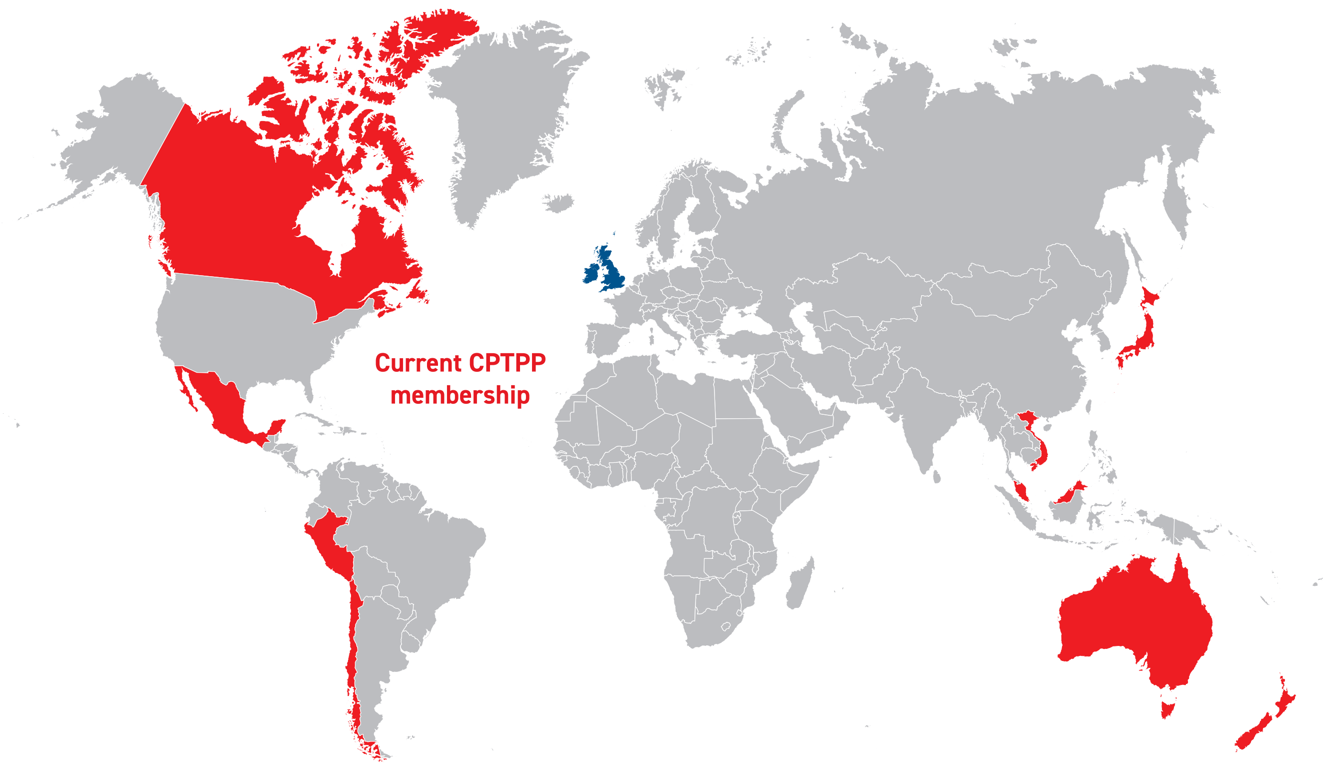
The UK government has finally wrapped up two years of haggling over quotas and tariffs and unveiled an agreement to join the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, or CPTPP, an 11-member Asia-Pacific trade bloc. The UK will be the first country to join the CPTPP since the group was established in 2018 (following Trump's decision to remove the US from a similar TPP pact). Accession to the bloc, the members of which include Canada, Mexico, Japan and New Zealand, will make 99% of UK goods exports to CPTPP countries eligible for zero tariffs.

When the idea of Britain joining the CPTPP was originally proposed, they were derided as impossible. But with the accession process now being formalised, the deal represents a huge triumph for Prime Minister Rishi Sunak and Minister for Trade, Kemi Badenoch. It also marks the point at which Brexit cannot be reversed. The CPTPP bloc has an equivalent economic weight to the EU minus the UK and the differences in the rules between the two bodies makes it impossible for the UK to rejoin the EU, or even the EU's customs union, without first leaving the CPTPP.

Supporters of Brexit may say this is the ultimate pay-off of our decision to leave the EU and write our own rules. The trade-off, though, is that Britain will now be forced to accept imports even where there are real differences in standards. The UK will come under inevitable pressure to accept food containing pesticides that are not currently permitted such as antibiotics in livestock farming or hormone-treated beef. Worse, the 'Corporate Court System" at the heart of the CPTPP will allow corporations to sue the British government for treating them unfairly. All this for a boost to GDP estimated at only 0.08% over ten years.

The immediate benefits for Britain will be limited given that it already has free-trade agreements with all the countries in the bloc except Malaysia and Brunei. And it will do little to improve market access in services, which account for 43% of Britain's exports. Still, membership will give Britain influence over how the bloc might develop in the future and a seat at the table among what are forecast to be some of the world's fastest growing economies over the coming decades. Britain will also wield a veto over future entrants, which include China. The real significance of the deal lies more in geopolitics than in any boost to GDP.

The US will be happy that Britain could help block China's entry to the CPTPP. Joining comes with a political bonus for the UK Government too. Any future Labour government might now find itself on the wrong end of a court judgment if it tries to push environmental protections, carbon taxes, or enhanced workers' rights.



Bargains in UK commercial property

Real estate investment trusts are out of favour due to rising interest rates and fear of weak demand for property. That sell-off has been so severe that bargains are now emerging.

The UK loves investing in property. For most people, the biggest asset they'll ever own is their house, and buy-to-let investing has become somewhat of a national pastime.

Ask most people if they invest in stocks and shares, and the answer is usually "no, it's too risky". But ask them if they invest in property, and if they're not already a buy-to-let investor, the chances are they'll say they want to be – although whether or not this remains a sensible option with interest rates where they are today remains to be seen.

If you need evidence that the UK loves property more than anything else, consider that the value of the UK's housing stock hit a high of £8.7trn last year, according to real estate firm Savills. That's around three times the size of the UK equity market (£2.4trn at the end of February 2023) and pension savings (around £3trn).

However, whilst the UK loves to own and invest in physical property, real estate investment trusts (REITs) are often overlooked, despite offering attractive tax treatment, solid income and a useful way to diversify a portfolio.

The UK's REIT regime was launched in January 2007 as part of a drive to open up the UK's financial markets to international investors. While they are still a relatively new structure in the UK, REITs were first launched in the US in 1960, and 45 countries worldwide now have provisions for REITs in their tax laws. Most established UK property companies quickly chose to convert into REITs, so the history of many of these businesses goes back much further than 2007.

Put simply, REITs are property companies with tax benefits. They don't need to pay capital gains tax on property sales, and there's no tax on rental income as long as 90% of income earned from rents is returned to shareholders. These benefits make REITs an incredibly tax-efficient strategy for investing in property.

REIT's pay property income distributions (PIDs), which are similar to dividends, but qualify as property income, not dividends. Therefore, they're taxed differently (at the normal rate of income tax, not the dividend tax rate). Basic-rate tax (20%) is withheld at source and additional tax will be liable for UK residents who fall into a higher tax bracket.

UK Residents can also hold REITs in an Individual Savings Account (Isa) or Self-invested Personal pension (SIPP), making distributions entirely tax-free.

As well as these tax benefits, REITs also come with stamp duty benefits compared with other routes to investing directly in property – stamp duty on share transactions is only 0.5%. For non-residential property transactions, the rate is 5% for properties worth more than £250,000. And if you're a residential buy-to-let investor, the rate is 8% over £250,000. On these tax benefits alone, it's worth considering REITs in most client portfolios that we advise on. However, they also help investors gain exposure to sectors they'd usually be unable to buy access to without a huge pool of capital. For example, few small investors are going to be able to buy a portfolio of central London offices and residential properties, but you can do just that with a REIT.

Despite their appeal as tax-efficient income investments, many REITs are currently trading at large discounts to their net asset value (NAV). At the end of February, the largest UK-listed REITs were trading at an average discount to NAV of 13%, with some trading at a discount of as much as 50%. What's more, a quick glance at the residential and commercial REITs sector in the UK shows investors can earn a yield of as much as 9.5% – a very desirable return in the current environment.

So why are REITs so cheap? It comes back to interest rates and the cost of capital. If a property has the potential to earn £5m in rental income a year, and an investor can borrow the money to acquire this asset at 3%, they might be willing to pay up to £100m for the asset. This would give them a 5% return on the asset, easily exceeding financing costs.

But in a world where the Bank of England base rate sits at 4.25% and could rise as high as 5%, investors are not going to want to lock their money in at a 5% return – that would hardly cover their cost of capital. A return of 7% might be more acceptable. Assuming the asset still generates the same level of income, to earn a 7% return, a buyer would only be able to pay £70m. That asset, which was worth £100m a few years ago, could now be worth a lot less.

This is part of the reason why REITs have fallen out of favour. Higher interest rates will hurt property prices, and this will hit NAV values.

Some property investors will undoubtedly take losses on their property holdings in a high interest-rate environment. Those investors that have yet to hedge their debt will face

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higher interest rates, and tenants with lots of borrowing may struggle to pay their bills.

There are also environmental rules to consider. Commercial property owners will need to renovate their buildings to the meet an energy performance certificate (EPC) rating of C by 2027 and B by the end of the decade. If they do not do so, it will no longer be possible to rent these properties out. This will mean substantial capital expenditure for landlords with a large amount of below-spec property.

However, high-quality assets, let to tenants on inflation-proofed rental agreements, are beginning to look very attractive amid the current market turmoil.

Traditionally, in the UK commercial property market, rents would be reviewed on a set timetable, usually every five years. However, it's increasingly moving towards the European model whereby rental agreements are index-linked, bringing a level of stability and predictability to the market. In a high-inflation environment, these index-linked contracts are highly attractive – especially when companies have been able to fix their debt at a low rate of interest.

Index-linked contracts don't prevent interest rates from having an impact on property values, but they provide a level of protection for asset values and support dividend growth. However, the market does not seem to be distinguishing between those companies with index-linked income streams and high-quality assets. It just seems to be selling everything.

As well as inflation-linked income streams, some REITs own unique assets, which are only gaining in value. The future of the office market has been subject to a lot of speculation over the past three years as the pandemic has upended working habits. However, it's becoming clear that the office isn't dead – it's just evolved. Places like central London, central Manchester and central Birmingham are going to remain attractive places to invest because they are attractive places to work.

Central London is a case in point. Last year, take-up of office space in the capital rose 24% compared to 2021, according to property consultants Knight Frank. While total letting volume was still down on pre-pandemic levels, a lack of high-quality, energy-efficient space in the most sought-after locations saw rents jump. Rents in London's West End hit their highest levels on record of £127.50 per square foot. Meanwhile, City rents remained stable at rates of £77.50 per sq ft.

Rents in central London are rising as demand is rising and supply is constrained. Since 1994, the total stock of offices in the West End has actually declined even though the number of office workers has risen nearly 80%.It's no wonder rental growth has risen 180% during this time, far outpacing inflation.

This trend is going to get worse. The number of office buildings in the pipeline is below average for the next three years, even though demand is picking up. In parts of the capital, there's less than ten months of office demand in the pipeline. A lack of supply, which can't easily be cured, rising demand and rising rents mean all of the London-focused REITs look attractive.

New pact sees off China

The US, UK and Australia have formally unveiled the Aukus agreement which creates a new fleet of nuclear powered submarines aimed at countering China's influence in the Indo-Pacific region. The deal will give Australia its first nuclear-powered subs from the US, and the three countries will work to create a new fleet using cutting-edge technology, including UK-made Rolls-Royce reactors. For Australia, the deal represents a major upgrade to the US ally's military capabilities – the submarines will be able to operate further and faster than the country's existing diesel-engine fleet and Australia will also be able to carry out long-range strikes against enemies for the first time.

The three nations have established 17 joint working groups, nearly half of which relate to other advanced military technologies, including underwater drones and quantum technologies for positioning, navigation and timing, intelligence, cyber-defence, hypersonic missiles and electronic warfare. The idea is that by pooling talent and resources, the US and its allies will be able to compete more effectively. It should, in particular, enable them to catch up with China, which has a lead in 37 of 44 key technologies.

The deal has not gone down well in Beijing who said the pact represented "a typical case of the Cold War mentality". China warned Britain, Australia and the US that they were treading a "path of error and danger". The submarines that form part of the deal won't be nuclear armed, but China has nevertheless complained to the United Nations' nuclear watchdog that the deal will "only stimulate arms races, undermine the world nuclear non- proliferation system and damage regional peace and stability". Russia has similar concerns, saying that "the advancement of Nato military infrastructures into Asia is making a serious bet on many years of confrontation".

China needed to be told that there are constraints on how far it can go, and that any "overreach" on its part will trigger a confrontation. The Aukus deal sends that message. The chaotic US withdrawal from Afghanistan and the West's limited response to the 2014 invasion of Crimea by Russia made the West look weak. Its support for Ukraine over the past year is changing things, but the main test will be the extent to which liberal democracies are able to challenge and balance Chinese power in the Indo-Pacific. Aukus will make China think twice before being yet more assertive in the South China Sea" or invading Taiwan.

And it's not just Taiwan under threat. The melting ice caps make it possible that Chinese subs will soon be operating closer to European waters. It makes sense for Britain, in particular, to play a more proactive role in building a defensive alliance.

The risks are manifold. The project will need to endure at least three American presidential terms beyond Mr Biden's current one and more than three British elections — a stiff test, even though it has bipartisan support in all three countries. The cost to Australia could be $180bn-245bn over 32 years, according to early estimates. For Australia to produce the necessary skilled labour and nuclear expertise will be hard. "This is potentially a 100-year endeavour," observed Peter Malinauskas, the premier of South Australia, of which Adelaide is the capital.

But the pay-off would be high. For Britain, the benefit is not just a shot in the arm for a submarine industry that has struggled with stop-start construction. It also gives real substance to the government's wished-for "tilt" to the Indo-Pacific. Critics had questioned the wisdom of emphasising naval power in Asia while a land war raged in Europe.

For America, Aukus and the related agreements are the latest and most dramatic step in its steady consolidation of Asian alliances. It is readying to sell hundreds of cruise missiles to Japan and, in January, agreed to upgrade a marine regiment in Okinawa. In February it secured access to four extra bases in the Philippines.

The fact that Aukus survived the transition from Australia's centre-right Liberal party to Mr Albanese's centre-left Labor party last year reflects the consensus now baked into Australian politics over the threat from China and the need for drastic measures to confront it. A defence review in 2020 concluded that the prospect of a major war was "less remote than in the past" and the government could no longer be assured of a ten-year warning of such a conflict.

But the scenario that weighs most heavily on American planners is a larger war over Taiwan. "Aukus has one overriding objective," declared Mr Biden, in front of the USS Missouri, "to enhance the stability of the Indo-Pacific amid rapidly shifting global dynamics." Eight additional submarines prowling in the South and East China Seas would make it significantly harder for China to get an invasion force across the Taiwan Strait or to escalate elsewhere.

That will add to deterrence.

US property market points to recession

The importance of American housing resides not so much in its absolute size, big though it is at about $45trn in total value. Rather, it serves as a bellwether of the economy's performance amid rising interest rates. Has the Federal Reserve lifted rates by enough to calm inflation without crushing growth? Has it gone too far? Or, perhaps, not far enough? As one of the earliest and largest sectors to react to changes, the property market offers some answers.

Until the past month, the evidence seemed straightforward. Even before the Fed started increasing rates, mortgage lenders, anticipating the bank's tightening, had started charging more. From 3% at the end of 2021, the rate on 30-year fixed mortgages surpassed 7% by October, the highest in more than two decades. Activity quickly tailed off as buyers stayed on the sidelines. Builders scaled back new construction projects and sellers trimmed prices.

But signs of an early and largely unexpected rebound have emerged, prompting concerns that higher rates are not having the desired effect. New home sales jumped in January to a ten-month high. Surveys gauging the confidence of both homebuilders and homebuyers have improved. Buyers are returning but the covid-era frenzy is not. A decent spring season could, in theory, allow prices to stabilise and builders to resume construction, boosting growth without stoking inflation.

The interaction between the property market and inflationary trends is too powerful to ignore: if buyers return to a supply-constrained housing market, price rises will follow. And if the Fed sees that such a rate-sensitive sector as property is not responding to tighter monetary policy, it may judge that it needs to be more aggressive in increasing interest rates. Unfortunately for America, and the world, this pessimistic case looks more plausible.

Analysts point to a range of factors behind the rebound. After a year of sluggish sales, there is pent-up demand. Richer buyers, paying in cash, represent a larger share of the market. Buyers may also be getting used to higher rates: some saw a good deal when mortgage rates fell from north of 7% late last year to 6% in January.

Perhaps most crucially, developers are offering a range of incentives. There is nothing unusual about using discounts when the market falters. The novel element, this time, has been aggressive use of mortgage subsidies through in-house lenders, in effect prepaying some interest on behalf of customers to reduce mortgage rates. This has allowed developers to offer mortgages that seem to come from the pre-inflation era.

These discounts are a clever bit of financial engineering. The obvious question is whether such discounts are sustainable. Homebuyers would struggle to resell their homes at the same price to buyers not benefiting from mortgage buydowns. As a result, valuers may cut home valuations on their appraisals, forcing sellers to lower prices.

Last year Jerome Powell, the Fed's chairman, spoke of the need for "a bit of a reset" in the property market. That reset has further to run. Mortgage payments on new homes now reach nearly 30% of average household income in America, almost double their average in the 2010s. Bringing affordability back to pre-covid levels would require either a rise in incomes or a decline in mortgage rates or a decline in house prices. All three have started to happen, but there is a long way to go. Nationally, home prices have fallen by just 4% since their peak in mid-2022, barely eating into their 45% surge during the pandemic.

Mortgage payments on new homes now reach nearly 30% of average household income in America, almost double their average in the 2010s. Bringing affordability back to pre-covid levels would require either a rise in incomes or a decline in mortgage rates or a decline in house prices.

Investment in residential construction fell by 20% in real terms last year. It appears set to fall further this year. Strikingly, despite the rebound in demand, new construction have so far fallen. You've never really had a time where there have been price declines and a significant decline in residential investment, and a recession has not happened.

This runs counter to the hope in financial markets that America can steer clear of a downturn.

Party in the Gulf

In an era of war and global downturn, Gulf states are bucking the slump, enjoying record growth and attracting investors – many of them from Britain. The Gulf is going through a golden age – bigger and better than we saw in the oil booms of the 70s and 80s.

After rising by 9% last year, Dubai's GDP is expected to grow by 5% a year until the end of 2025. The stock market climbed 4.4% last year. House prices in prime areas have more than doubled in the past two years, catapulting the city state to the top of Knight Frank's global ranking. Average villa prices are up by 37%. Tourist visitor numbers are nudging 2019 levels across the United Arab Emirates, including in Abu Dhabi, the capital. The outlook is so rosy that Dubai's ruler, Sheikh Mohammed bin Rashid Al Maktoum, has set out a £7 trillion plan to double foreign trade and investment over the next decade, making Dubai one of the world's top four financial centres.

Sheikh Mohammed is not alone. Mohammed bin Salman Al Saud, Crown Prince and Prime Minister of Saudi Arabia, is taking advantage of the fastest growth rate in the G20, 8%,to embark on a £4 trillion programme to diversify the economy and generate growth in the post-oil era.

Bin Salman has earmarked more than £2 trillion for new cities, financial centres and infrastructure. He has bold plans to attract 100 million tourists a year by 2030 to a country once closed to visitors except pilgrims. Some observers speculate he might legalise the sale of alcohol in some Red Sea resorts to attract them.

He is building the world's largest airport, to handle 185 million passengers a year, and launching a new airline, RIA, to compete with Emirates, likely to be led by Briton Tony Douglas, who ran Etihad, the Abu Dhabi flag carrier, until October.

Tamim bin Hamad Al Thani, the emir of Qatar, is using the success of the recent World Cup and the £200 billion he spent on the tournament to make Doha the sporting hub of the Middle East. He has signed deals to host a Formula One grand prix every year from next year until 2033. Doha will stage football's Asian Cup in 2024, as well as the World Swimming Championships, and the Asian Games athletics tournament in 2030. A bid for the 2036 Olympic Games is likely to follow.

When the rest of the world is battling recession, what's behind the Gulf boom? Dubai is the beneficiary of global political instability. In times of crisis, the Arab Spring, Covid, Dubai becomes a haven for investors because it offers security and stability, as well as good weather, schools, healthcare, leisure and entertainment.

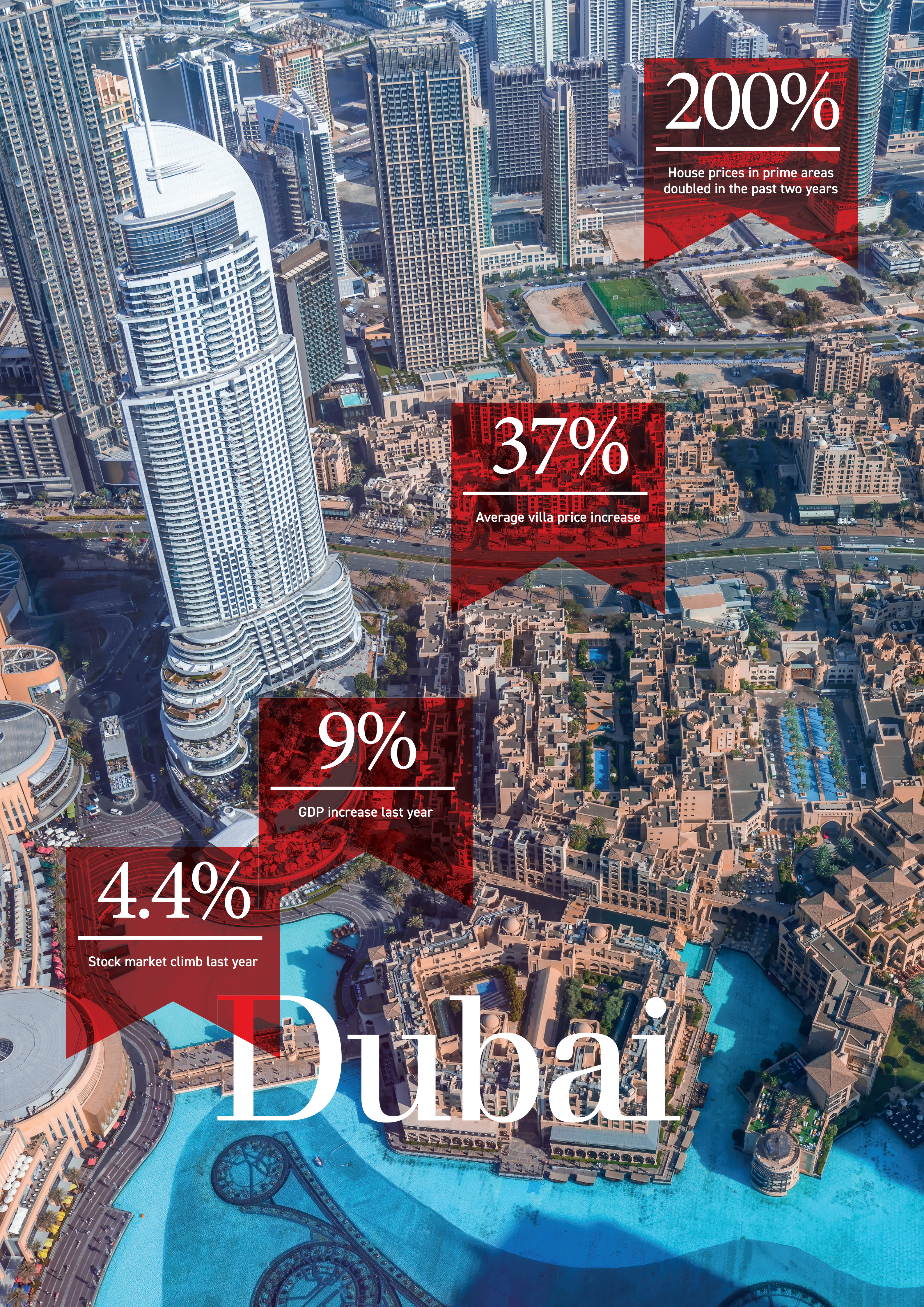
Among those flocking to Dubai are Russians fleeing war and, in some cases, sanctions. The UAE has adopted an economically-convenient position of neutrality on war in Ukraine. Expats enraged by anti-Covid lockdowns and restrictions on political freedom are swapping the tropical climes of Hong Kong and Singapore for Dubai's desert heat.

Political change of a different kind — the Abraham Accords that established diplomatic relations between the UAE and Israel — means the Emirates and El Al flights arriving in Dubai are full of entrepreneurs eager to cut deals with Arab-owned firms. Indians are putting down roots, thanks to an attractive new long-term residency programme. New arrivals get a three-month visa and those who invest in a local business or property can qualify for a ten-year visa. Many joke that 'the best place in India is Dubai'.

To add to Dubai's traditional strength — a stable currency linked to the dollar, no income tax, low VAT and low corporation tax — Sheikh Mohammed has introduced social reforms to make the emirate friendly to foreigners. A ban on unmarried couples living together was lifted and the working week switched to the global norm of Monday to Friday, even though Friday is the Muslim holy day.

Goldman Sachs, JP Morgan, Citigroup, Société Générale and Bank of America have moved hundreds of employees to Dubai, pushing up office rents by 35%.

For Qatar, which has the third-largest reserves of natural gas in the world, the driver of growth is the record gas price. It quadrupled after Russia invaded Ukraine and Moscow cut piped supplies to Europe. Qatar seems to be in the right place, at the right time, with the right resources. IMF data shows that high oil and gas prices mean Gulf states will reap up to £1.1 trillion in additional revenues in the next four years.


200%
House prices in prime areas doubled in the past two years
37%
Average villa price increase
9%
GDP increase last year
4.4%
Stock market climb last year

Dubai

Saudi Arabia and UAE

70%

Saudi Arabia and UAE account for 70% of GCC's $2trn GDP

8%

Saudi Arabia had the fastest growth rate in the G20

Saudi Arabia is benefiting from the reforming zeal of bin Salman who is racing to diversify the economy and create new jobs for a youthful population. To attract foreign multinationals and boost productivity, he has loosened social and religious restrictions. Mixed-sex restaurants and cafés are commonplace, and men and women mingle freely at arts festivals, in cinemas and at sporting events.

What many are asking now is: will the current boom turn to spectacular bust as so often in the past? However, the foundations of growth are much more secure now. Government debt across the region is lower than it was in 2008 when the global financial crisis plunged the Gulf states into crisis. There's also more liquidity and economies are far more diversified. The reopening of China will also buoy growth.

But there are clouds on the desert horizon. Dubai has light-touch regulation, valuable now that secretive banking boltholes like Switzerland are co-operating with authorities seeking to seize Russian-owned assets. This business model may not prove quite so easy to pursue in future.

Western governments and global regulators are monitoring money flows into the emirate after the Financial Action Task Force, a global watchdog, put the UAE on a grey list of territories that do not do enough to counter flows of money from uncertain sources. The UAE insists it "takes its role in protecting the integrity of the global financial system extremely seriously".

Saudi's grand projects are showing signs of strain. Built at breakneck speed, some developments are suffering setbacks. It also remains unclear whether western investors will set aside concerns about bin Salman's leadership. US authorities believe he authorised the capture or killing of the Saudi Washington Post journalist Jamal Khashoggi, a critic of Riyadh, who was murdered in the country's consulate in Istanbul in 2018. Bin Salman denies involvement.

And overshadowing Qatar and all the Gulf states is the risk of conflict between Israel and Iran, which many observers now say has acquired nuclear weapons.

But none of these concerns are on the mind of most partygoers enjoying partying in Dubai. The Middle East looks to be the epicentre of hospitality and much else besides. Optimists are convinced that this is the place to be.

Investing in the Gulf

Recent reforms in the Gulf are real but risky. For decades the six members of the Gulf Co-operation Council (GCC), a club of petro-monarchies, maintained similar social contracts. Oil and gas revenues topped up their treasuries. Citizens reaped benefits in the form of subsidies, handouts and well paid public-sector jobs. Foreigners came and worked as long as they were useful. The two groups lived mostly separate lives.

No longer. The past few years have been a time of rapid change in the GCC. Saudi Arabia is shaking off many of its social restrictions and opening to the world. Policies that were unthinkable, from subsidy cuts and new taxes to cohabitation and civil marriage, are being implemented with little fuss. There is talk of shrinking the state and moving more jobs to the private sector.

The GCC does not act as one. In Kuwait, it feels as if nothing has changed for a generation. With an ocean of natural gas and a tiny population, Qatar is in no hurry to shrink the public-wage bill. But Saudi Arabia and the United Arab Emirates (UAE) have moved fastest. Together they account for more than 75% of the GCC's population and 70% of its $2trn GDP. Their experience will have an outsized impact on the region.

Rulers in both countries reckon this is their moment to have it all. They have plans to diversify their economies and prepare for the post-oil era. They want to be global players in diplomacy and business. And they want to keep their citizens happy.

Whilst these goals are to be celebrated, they are also in conflict. Diversification means pushing citizens into a private sector for which some are ill-prepared. It also means benefit cuts that punch holes in the paternalistic social contract. To compensate, rulers are pushing new forms of nationalism—even as they pursue plans that require importing crowds of foreigners to a region where around half the population are already migrants .

These are hopeful but confusing times in the Gulf. Economies and societies are opening, but political life is closing.

The most visible changes are in Saudi Arabia, governed for decades under an austere brand of Islam. Prince Muhammad, the crown prince and de facto ruler since 2017, has loosened its grip. Women were permitted to drive in 2018. Cinemas, banned since the 1980s, reopened the same year. The kingdom now hosts concerts and raves. Alcohol is still illegal but that may soon change, at least in select areas meant to draw rich foreign tourists.

Such changes serve a few purposes. They have made many Saudis enthusiastic supporters of Prince Muhammad. Few miss the mutawwa, the once-feared religious police who harassed people for missing prayer times or wearing make-up. They are also lucrative. For decades, Saudis had to travel to more libertine Gulf cities like Dubai, or further afield, to let their hair down. Keeping them (and their money) at home is good for the Saudi economy.

The social revolution also makes the kingdom more appealing to foreigners. Prince Muhammad has told multinationals to move their regional offices to the kingdom by 2024 or risk losing government contracts. Some bosses still fret about everything from the business climate to the lack of international schools. But the changes have made the move an easier sell.

All of this poses a challenge for the UAE, long the preferred business hub in the Gulf. Consultants fly over to Riyadh for meetings during the week, then back to Dubai for weekend fun. Worried about losing its competitive edge, the UAE has rushed through its own social changes.

Over the past three years it has overhauled family laws that were long governed by sharia (Islamic law). Abu Dhabi, the capital, started conducting civil marriages for non-Muslims in 2021. The other six emirates followed suit this February. Since 2020 unmarried couples have been allowed to live together, previously a crime (if rarely punished). Looser alcohol laws make it easier for Muslims to indulge.

Since 2018, four of the six GCC members have introduced a value-added tax. The UAE will start collecting a 9% corporate tax in June. Income tax of some sort is likely to emerge too. The Gulf's social contract meant zero taxes for citizens and expats. That is no longer the case.

Life is getting more expensive in other ways, too. The UAE stopped fuel subsidies in 2015. Whilst petrol is still cheap by global standards, it is 30% more expensive than in Saudi Arabia and almost 150% costlier than in Kuwait. Most Gulf states have raised power and water prices that were once well below market rates. Oman, which had not changed its electricity tariff for 33 years, did away with a discounted rate for citizens: they now pay the same as expats.

Such changes have had a real impact. The 2012 Saudi budget projected that non-oil sources would contribute less than 8% of total revenue. A decade later, even with sky-high oil prices, that figure was up to 31%. For citizens, higher taxes and lower subsidies have made life more difficult. Whilst foreigners feel pinched too, they are still flocking to the Gulf. The UAE is experiencing a boom as everyone from

rich Russians to cryptocurrency entrepreneurs rushes to set up shop in Dubai. It has low inflation, a stable currency and plentiful sunshine. A 'golden visa' scheme introduced in 2019 grants long-term residency to skilled professionals and rich investors without the need for a local sponsor. In 2021 the country announced that it would offer citizenship to select foreigners.

While the rest of the Arab world seems to be in terminal decline, the GCC is prosperous and well-governed. Citizens might grumble, but there is little demand for political change. There remains trust in the system, based on a solid, 50-year record of good governance. The state doesn't have to be democratic. It needs to deliver.

The question, as Gulf states try to transform their economies and societies, is whether they can preserve that trust. One concern, usually voiced by Westerners, is that openness will prompt a conservative backlash. Apologists for Prince Muhammad justify his crackdowns by invoking the spectre of religious conservatism. Such concerns are probably overblown. A younger generation of khaleejis is more open-minded than their parents. Once an organised force, Islamists wield less power in today's Gulf.

The UAE does not release reliable figures on unemployment. But unofficial estimates suggest that around 11% of young people are jobless. In Saudi Arabia, 17% of citizens aged 15 to 24 cannot find work. Bahrain's youth-unemployment rate has almost doubled over the past decade, reaching 10% in 2021. Some of the increase can be explained by the pandemic. But it also reflects a unique issue in the GCC: young people are stuck between a public sector that no longer wishes to hire them, and a private sector that is not ready to.

Like the other Gulf countries, the UAE is trying to persuade companies to hire more citizens. Each firm is required to have Emiratis in 2% of its local positions, rising each year until it hits 10% at the end of 2026.

On social media, Emiratis grumble about foreigners taking all the good jobs. Expats accuse locals of being spoiled and lazy. Such arguments would have been rare in decades past: the two groups had little reason to interact. Today they are being pushed into competition, and some locals are discovering they are unprepared.

In tests of science, maths and reading, 15-year-olds in the UAE score well below the average for the OECD, a club of mostly rich countries. In the latest exams run by the Programme for International Student Assessment, in 2018, the UAE ranked 47th out of 77 countries. Its neighbours are not doing any better. Qatar and Saudi Arabia ranked 59th and 70th, respectively.

The UAE would have ranked lower still without expat pupils, who outperformed their native-born peers. Boys do particularly badly: the 57% gap in their reading scores, compared with girls, is the second-highest in the world. Researchers point to many problems with Gulf education. Teachers, often hired from abroad, are of mixed quality. Schools emphasise rote memorisation over critical thinking. Many children are raised by nannies who speak neither Arabic nor English fluently. And the promise of a public-sector job, regardless of ability, offered little motivation to work hard in school.

Similar changes are taking place across the Gulf. For decades, Saudi identity was rooted in its religious role: the birthplace of Islam and the home of its holiest sites. Prince Muhammad wants to change that. The kingdom's national day, in September, is now a time for patriotic celebrations. His government is investing billions to develop Al-Ula, an oasis that boasts spectacular Nabataean ruins. Conservative clerics hate it as a monument to jahiliyya (ignorance), a term for the pre-Islamic era on the Arabian peninsula. Now the Saudi state is building hotels, organising festivals and urging both locals and foreigners to visit the site. Pagan history is suddenly to be celebrated, not shunned.

Dubai's red hot property

Dubai, the commercial capital of the United Arab Emirates, has had lots of good news in the past two years. Lax restrictions during the pandemic lured expats whilst Russia's invasion of Ukraine brought another influx of new residents. High oil prices also added to the boom-time feeling. Restaurants and bars were found heaving, rush-hour traffic back to pre-pandemic levels registering a record number of passengers using public transport in February.

But too much good news can be a bad thing for some residents. Annual inflation hit a 14-year high of 7.1% last summer, partly due to soaring petrol prices. It has since dropped to less than 5%, below many other rich economies. But the headline number does not tell the full story.

Official inflation figures for 2022 showed just a 0.6% increase for housing and utilities, which make up 41% of the consumer-price index. These track all leases, however, do not reflect recent rises in rents; many in Dubai are feeling steeper increases. Apartment rents rose by 28% in the year to February, to almost 100,000 dirhams (about $27,200).

Three factors explain the surge. One is demand, from Russians and other new arrivals. Many seek to live in Dubai's most fashionable areas. On Palm Jumeirah, an artificial island in the Gulf, a two-bedroom flat that rented for 100,000 dirhams two years ago can now fetch 215,000 dirhams. Next is a booming property-sale market. Apartment prices are at their highest in almost a decade. Some investors who bought homes early in the pandemic sold them, two years later, for profits of 50% or more. Rising prices have made some landlords unscrupulous, asking for rental increases beyond the 20% per year allowed by law.

Dubai's property market has much to recommend it, from low taxes to a vast pool of would-be renters. But some wonder if the sector, the backbone of Dubai's economy, is again becoming a bubble. The city has already endured two real-estate crashes this century: an abrupt one during the financial crisis in 2008, when property values fell by half, and a slower one from 2014 to 2020, when they slid by 35%. Buyers are still piling in, but some rental rates may be peaking. In popular areas like the Palm and downtown Dubai, they were either flat or declined in February, according to local agents. Instead, they grew in less desirable inland areas — suggesting that renters are voting with their feet.

Other prices are climbing. Annual food and drink inflation was above 6% in February. The UAE imposed price caps in 2022 on a few staples. Authorities shut down a local newspaper that covered the issue or rising petrol prices. School fees are a burden for expats. Despite its reputation, salaries in Dubai are not keeping pace with rising prices. Cooper Fitch, a consultancy, estimates that they will increase this year by only around 2%.

Some of this galloping inflation should be temporary. Rental prices may drop as landlords temper expectations and new homes enter the market.

Some economists argue that the UAE should try to ease the tax burden on residents and firms. It introduced a 5% value-added tax in 2018, and in June it will start to collect a 9% corporate levy. Even as it introduces formal taxes, it has kept many of the fees that amount to stealth taxes, like a steep housing surcharge added to electricity bills in Dubai.

One bright note is that, in January, the emirate suspended its 30% tax on alcohol. That will be comforting for residents who want to forget their new rental contracts.

28%

Apartment rents rose to almost $27,200

Can Eastern Europe's tiger economy keep roaring?

Poland has gone from rags to riches in one generation, while its equities remain cheap. But headwinds are gathering strength, and the next few decades could prove a struggle.

Could there be eastern promise closer to home than we thought? Recent projections show that on current growth trajectories the average Pole will be £500 a year better off than the average Briton by the end of the decade, and even Hungarian and Romanian incomes will overtake the UK by 2040. For now, the UK is comfortably richer than Eastern Europe, with a GDP per capita of $50,809, compared with $38,125 in Poland (after adjusting for living costs). But while Britain's economy has stagnated since 2010, Poland's has grown at an annual rate of 3.6%. An economy that expands at 3.6% for 50 years will end up nearly six times bigger than where it started. But if you crawl along at a mere 0.5%, your GDP will expand by barely 25% in half a century.

Many fear that unless something is done, Britain will end up with a 1970s-style brain drain. The age of the Polish plumber is ending. Instead, Britain's best and brightest may one day seek work in a Warsaw start-up.

In the 16th century, Poland-Lithuania was a major European power. The eminently photogenic architecture of Krakow, once the capital, still reflects that age of prosperity. But Poland's golden age was not to last. The country's curse is that it lives in a tough neighbourhood, surrounded by powerful empires and with few natural boundaries to halt invading armies. The rising states of Prussia, Russia and the Austrian Hapsburgs slowly dismembered the Polish-Lithuanian Commonwealth until by 1795 it had ceased to exist. A few decades of independence followed World War I, but that independence was again extinguished by Nazi Germany's 1939 invasion. During the Cold War Poland's leaders answered to the Soviets in Moscow.

Poland has spent less than 60 of the past 225 years as a self-governing nation. The socialist planning of the communist era ended in economic disaster. The collapse of the communist regime ushered in sweeping reforms. Poland's open and transparent privatisation process avoided the dire outcomes seen elsewhere in Eastern Europe, where privatisation created a corrupt oligarch class. The reward was rapid growth, with GDP per capita rising tenfold in the three decades after 1990. Like the tiger economies of the Far East, Poland has gone from rags to relative riches in just one generation.

Poland was the only EU state to avoid recession during the 2008-2009 global financial crisis and has done better than most emerging economies partly because it is next door to Germany's vast economy. EU integration has enabled it to fit smoothly into German industrial supply chains. Germany is by far Warsaw's biggest export partner, accounting for about 28% of all Polish trade. What was once a geographical curse has turned into an economic blessing.

Today the nation of 37.7 million is the EU's fifth-largest member by population and the bloc's sixth-largest economy. It also has growing diplomatic clout. Warsaw had spent years warning about the danger posed by Vladimir Putin. It proved correct when Russia invaded Ukraine last year. Poland has reacted to the war by turning itself into Nato's key frontline state, managing vital supply lines into Ukraine, welcoming 1.5 million Ukrainian refugees and vowing to raise military spending massively.

Normally investors would expect to pay a steep premium to buy into such a fast-growing economy. Yet Poland offers the rare combination of rapid growth coupled with bargain stocks. One key reason is that the market is biased towards the sort of sluggish old-economy stocks that don't tend to excite investors. Financials account for a hefty 39% of the MSCI Poland index, with energy making up another 20%. Investors in London's similarly unfashionable FTSE will find Warsaw's predicament familiar.

Secondly, pension reforms in 2014 have seen local funds diverted away from equities towards fixed-income and international assets. That has reduced the pool of domestic capital available to equity markets, thus putting a lid on valuations.

So are investors ignoring a massive bargain? Perhaps not. Poland's stellar growth performance has failed to translate into stock market gains. The benchmark WIG 20 index has long disappointed, and still trades at less than half of its October 2007 all-time high.

Poland's corporation tax rate of 19% and 32% top rate of tax are lower than those in most of Western Europe. With a government debt-to-GDP ratio of 68%, Poland's government also seems committed to the sort of fiscal rigour that Britain, where government debt exceeds 100% of GDP, can only dream of. Yet a closer look reveals that Warsaw's bureaucrats maintain significant influence over the economy. Government spending as a percentage of GDP sits at a similar level – just over 44% – in both the UK and Poland, according to the International Monetary Fund.

The Polish Treasury kept a stake in many of the companies it privatised, enabling it to continue wielding influence behind the scenes. The actual share of state-controlled enterprises in the Polish economy is around 15% per year probably the highest among all European Union countries. Poland's biggest bank and insurance company, for example, are both state-controlled enterprises.

Persistent state control extends to Poland's equity market too. Twelve of Poland's top-20 listed firms, representing nearly 80% of the WIG 20's capitalisation, have Poland's Treasury as a shareholder. The Polish government has very extensive power over the capital market in Poland. Like any government, investor returns are lower down the priority list than political imperatives such as maximising employment. No wonder returns have been so sluggish.

Warsaw's disregard for shareholders was shown last year when the government announced a moratorium on mortgage repayments. The policy allowed "borrowers to suspend payments for eight months", a move that threatens to wipe out bank profits for the year. Polish shares might be cheap, but that doesn't mean much when the government is ready to obliterate a year's earnings with a single edict.

Ostensibly a response to the cost-of-living crisis, the mortgage policy was not means-tested. Some think it is a pre-election giveaway, as Poland is due to go to the polls this autumn. The ruling Law and Justice Party, which has been in power since 2015, is usually described as right-wing. But while it is culturally conservative, free-marketeers regard Law and Justice as socialist because it stands for redistribution, nationalisation, and bigger government.

The party's new agenda is one of "economic patriotism", a formula that combines "nationalism with anti-capitalism". It "has been particularly successful with voters by claiming that the privatisation of state-owned enterprises is a sell-out to foreign capitalists". The party has also become embroiled in a long-running legal dispute with Brussels over judicial independence. Warsaw says that reforms affecting how judges are appointed are necessary to clear out the remaining communist-era elite, while many political analysts see an attempt to pack the courts with party supporters who will look the other way when corruption occurs.

After years of wrangling, Brussels has retaliated by blocking the release of €35bn in pandemic relief funds. The pressure has started to yield results. Desperate to get its hands on EU cash ahead of this year's election, the Polish parliament has agreed to roll back a few of the rules governing how judges are disciplined. That is a modest step, but it won't resolve the wider dispute.

Law and Justice appears poised to scrape another win in this autumn's elections, so the quarrel over whether Poland's judges are independent of the governing party is likely to roll on. Investors will be watching closely.

The growth miracle is also showing signs of strain. The economy shrank at a quarterly rate of 2.4% in the final three months of 2022, the worst showing in the EU. Inflation has reached 18.4% due to soaring global energy costs.

In 2021, the country recorded 520,000 deaths and only 332,000 live births. Alarming forecasts from the state statistics agency project that, by 2100, Poland's population will slide from 37.6 million to 23 million. While the government has sought to reverse low birth rates through "pro-family" welfare handouts, these measures have so far done little to raise birth rates.

The economy has other structural problems. OECD data shows that in 2020 Poland spent less than 1.4% of GDP on research and development (R&D), far less than Germany's 3.1% and even less than the UK's 1.7%. That doesn't bode well for future productivity growth.

Meanwhile, 36 of the 50 most polluted European cities are in Poland, the product of the country's long-standing preference for coal-generated electricity. Poland's growth has rested on high consumption, European supply chains and EU generosity, but it remains to be seen whether that growth model can keep delivering. If Polish growth does stumble then it wouldn't be the first time a European catch-up story went awry. In 1987 Italy celebrated overtaking the UK in per-capita GDP. Yet as Italy's post-war boom and cash from Brussels ebbed away, so did growth. Decades of stagnation have followed while the population shrinks.

Poland boasts competitive tax rates and labour costs, a robust education system and plenty more room for catch-up growth. But the next three decades of growth will prove tougher going than the last three.

Market report

Bonds
High grade Bonds appeal

Market volatility remains high now that concerns about financial instability have joined inflation concerns at the top of investor worries. Last year, Central Banks embarked on aggressive rate hiking cycles in order to cool inflation. This broke away from the core belief that 'lower for longer' was the right strategy to boost growth.

Cracks first appeared last year in areas like UK pensions, and we are seeing concerns spread into the banking system. The response from Central Banks so far has been to offer targeted liquidity and come up with private sector solutions to the banking troubles.

Within the asset class, high grade and investment grade bonds look attractive. With growth decelerating, the recent moderation in inflation will continue. Downward pressure on interest rates and inflation should translate to strong total returns.

Gold
Providing diversification

Gold touched a 12-month high in late March, breaking the psychologically important barrier of $2000 per ounce. Fears of a repeat of the global financial crisis drove a surge in demand for gold exchange-traded funds (ETFs), which registered inflows of almost 22 metric tons over the week ending 17th March, according to data from the Word Gold Council. The last time inflows were at this level was during the outbreak of war in Ukraine last year.

The metal has since shed some of these games as swift government actions in the US and Switzerland largely re-assured investors of immediate concerns. However, it will take time for confidence to be fully restored. Meanwhile, central banks continue to diversify into gold. Swiss gold export data showed a surge in Chinese demand last quarter.

These dynamics support holding gold as a hedge within portfolios.

Foreign Exchange
Swiss Franc appreciating

The US Federal Reserve is getting closer to the end of its rate-hike cycle, and markets are discussing the timing for rate cuts later this year. That tilt point is getting closer. The exact timing of the last rate hike is still uncertain and investors need to prepare for volatility, just as we have seen in recent weeks. Still, US inflation has started to fall, and the economy is likely to slow in response to the interest-hike cycle.

The Euro and the Pound should both benefit from a steadily improving economy and from Central Banks fighting inflation, which is still higher than in the US. This is their foremost goal. European Bonds offer higher yields which supports the Euro whilst a slow, but steady, appreciation of the Swiss Franc should shield Switzerland from potential financial market turbulences.

Commodities
Structural case intact

Recent turbulence in global financial markets has weighed on commodity prices. However, the structural case for exposure to broad commodities remains intact.

Accelerating growth in China, persistent production challenges, low inventories, and ongoing weather risks remains the key negatives for higher prices over time. As a result, a total return of around 20% for commodities is possible over the next year. Commodity exposure needs to be actively managed.

The price of base metals is likely to be higher at year end. Inventories are at structurally low levels and highly concentrated in China. That lack of supply will be supportive of prices.

Oil
Crude imports to China picking up

Oil prices have been very sensitive to the recent market turmoil and investors are likely in wait-and-see mode at present. Many will have limited appetite for adding crude exposure until oil inventory stabilises and provides a more positive environment.

While the oil market is likely to remain volatile in the near term, rising Chinese crude imports, which have been very strong since early March, and lower Russian production, is likely to life prices over the coming quarters.

Equities
Emerging Markets and Australia appeal

Following a strong start to the year, global equities have been losing traction since February amid a slower-than-expected moderation in inflation and, more recently, the increasing uncertainty around US regional banks, and the potential impact of tightening credit and liquidly conditions on economic growth. As interest rates are expected to stay higher for longer, there is limited room for a rerating of global equities. In addition, earnings growth should turn negative this year, making fixed income investments more attractive relative to equities.

Australia and emerging markets look to be an exception. Earnings growth for Australian companies have significantly improved recently, but look to be trading at a discount of around 10% compared to peers. For emerging markets, China's re-opening is providing a boost.

The energy sector remains cheap, even though the sector has outperformed the general market by 45% since May 2021. While attractive valuations may support the sector's performance in the medium term, oil price volatility and peaking return on equity may weigh on sector performance on a tactical basis.

Value and quality income stocks remain preferable to growth names which remain expensive in this high-inflation environment.

We've over 200 years experience in the world's largest Banks

Alexander Wade

Alexander is one of the most experienced London advisers in the international market, specialising in this field for over 17 years whilst at HSBC, where he was consistently recognised as one of its most accomplished advisers. He has over 25 years' experience in international wealth management.

Stuart Poonawala

Stuart has worked in financial services since 1998. In 2003, he helped to found HSBC's specialist London arm advising international clients which quickly became one of the bank's most successful UK divisions. In 2009, he launched Kubera Wealth, our sister company, focussing on providing quality advice to the UK market.

Graeme Cowie

Graeme is responsible for building our professional connections with international lawyers and accountants, as well as co-ordinating our relationship with key fund managers at a number of international Private Banks and Discretionary Fund Managers. He has spent over 20 years in financial services and investment management, most recently spending more than six years at UBS where he led the Strategic Partnership team.

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