Treasury Group
Weekly Money Market Report
19 November 2017

الوطني NBK

The FED on the Road for a Third Rate Hike

United States

Dollar Depreciates Despite Tax Progress

The US House of Representatives conceded Trump's tax reform bill last Thursday, after nearly a year of disappointments. The bill still faces challenges as it moves on to the Senate where Republicans have a narrow majority and political complications regarding the federal deficit, healthcare and the distribution of tax benefits. Moreover, not one Democrat voted yes on the tax reform bill at the House, suggesting that sphere of bias may also preside in the Senate. FX markets were relatively quiet following the outcome, due to the fact that all the risk now rests in the Senate showdown.

The divergence between short and long term US treasury yields caused the yield curve to flatten to a 10-year low on Wednesday after data showed a slight pickup in inflation. The flattening suggests the FED will continue to raise short-term rates. At the same time, US inflation, although trending higher, may remain subdued, limiting yields on longer-dated bonds. In details, the gap between two and ten-year notes shrank to 63.4 basis points, the narrowest since November 2007. The variance in five and thirty year yields lessened to 75 basis points.

On the monetary front, the US economic data delivered a double win for the FED last month with a pickup in price growth and an unexpected gain in retail sales, further solidifying expectations that policy makers will raise interest rates next month. The probability that the FED will hike for a third time this year, currently resides at 93%.

Moving to Japan, the BoJ Governor Kuroda reiterated last week that the central bank will persist with an aggressive monetary easing until positive inflation developments are made. Due to the fact that the Japanese economy has been in deflationary territory for 15 years, the perception in the economy is that prices will not rise, however Kuroda believes that inflation will reach the bank's 2% objective in the long term. The main central banks around the globe are moving towards the neutral rate, while the BoJ is diverging further and further from its peers. Hence, the policy divergence may keep the Japanese yen subdued and promote inflationary pressures in the country.

According to the IMF, the outlook on the global economy has improved thanks to Europe's robust growth. The IMF predicts that the European growth rate will rise to 2.4% for the current year from 1.7% recorded in 2016. The solid momentum in Europe should assist to produce price growth after many developed economies struggled for years with low inflation. The dominant uncertainty facing Europe is the Brexit process and what kind of trade affiliation Britain can set up when it leaves the EU. A disorderly Brexit could result in significantly lower growth for both Britain and the euro zone. On the monetary front, subdued core inflation points to the need for monetary policy to remain accommodative for an extended period, the IMF stated.

On the currency front, the Dollar index was under pressure at the start of the week due to uncertainty surrounding the details of the final version of the highly anticipated tax reform. On Wednesday the DXY depreciated to one month low of 93.402, but quickly reversed its losses after inflation data came in as expected and retail sales surprised to the upside. On the last day of trading, the greenback lost ground overnight on news that a subpoena was issued in October for US president Trump's election campaign documents. The index was down by 0.90% for the week.

As for the single currency, the euro began its upward momentum on Tuesday after robust European growth reached the market and on Wednesday the EUR/USD was trading at the highest level since October 13 at 1.1860. Last week, the euro's appreciation versus the dollar was significant and the single currency didn't hesitate to take advantage of the Dollar's weakness. The EUR/USD opened the week at 1.1666 and ended Friday's session at 1.1793.

The Sterling pound lost around 100 basis points to the US dollar last Monday after a report indicated that 40 Conservative MPs are getting ready to challenge May's leadership, while Brexit talks face a crucial deadline. Moreover, Brexit minister David Davis stated that Britain will not offer a figure or a formula for how much it believes it owes the European Union, highlighting the lack of progress plaguing the divorce negotiations. On Wednesday, the pound received support due to the Dollar's weakness and somewhat better than expected labor market report. On the last trading day of the week, the cable reached a 2-week high of 1.3259 after UK retail sales showed a yearly contraction of -0.3% rather than the -0.4% drop forecasted earlier. GBP/USD closed the week at 1.3211.

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The safe haven yen was in consolidation mode versus the US dollar last Monday through Tuesday. On Wednesday the dollar lost ground to the yen following a weak performance in US 10-year yield, which dropped to 2.33%, lower than the 2.41% seen in the previous day. On Friday the USD/JPY declined near one-month low to 112.38 after the demand for safe haven assets increased when reports that Trump's campaign has been ordered to turn over information to Mueller's investigation, while manufacturing data from the US disappointed markets. The US dollar lost 1.33% of its value to the yen last week.

In the commodities complex, the precious metal appreciated almost to one 1 month high of $1,289.09 on Wednesday as the US dollar remained under broad selling pressure. The greenback has been under pressure recently amid uncertainty over the fate of a major US tax amendment, causing an increase for safe haven assets. At the end of the week, the price of gold received further support after the release of disappointing US jobless claims data and manufacturing activity. The yellow metal ended the week at 1,294.33.

The price of crude oil was elevated on Friday while still incurring a weekly loss as investors feared the oversupply of output by the US. Moreover, falling expectations for an extension by OPEC weighed on sentiment. Brent crude oil closed at $61.92 a barrel on Friday, after opening the week at $63.44 a barrel.

Inflationary Pressures on the Horizon

US consumer inflation edged up only 0.1% last month, lowering the annual CPI to 2% from 2.2%. On the other hand, core consumer inflation took a different path rising to 1.8% from 1.7% seen in September. On the producer front, price growth peaked to the highest level in more than 5.5 years coming at 2.8% and the 12-month core rate inflated to 2.3% in October, the highest since the August 2014. The annual increase in PPI was mainly driven by higher energy prices.

The inflation report as a whole suggests an improving economy may finally be reviving inflationary pressures. The rise in PPI could support normal price behavior in the months to come if producers pass on the higher costs to the retail sector and there may be light at the end of the tunnel for the FED, who blamed low inflation on transitory factors. On the future outlook, the dollar index has depreciated by 5.4% this year against the United States main trading partners, which may help lift overall inflation in the country. The big picture for the FED is that the latest inflation readings support the Banks current pace of monetary tightening.

American Consumers Continue to Spend

The rise in retail sales for the previous month and an upwardly revised September data suggests American consumers will continue to fuel the economy in the fourth quarter. Sales grew 0.2% m/m in October, after a 1.9% gain in September. September's figure was the highest reading in 2 ½ years and was driven by increased demand in the wake of Hurricanes Harvey and Irma. Core sales also followed the momentum by expanding 0.3% in October after climbing 0.5% in September.

Looking at credit facilities, the Federal Reserve Bank of New York reported that auto loans and credit card liabilities surged in the three months to September, causing the total household debt to reach a new record high of nearly $13 trillion. The data suggests Americans are spending more easily as confidence in the economy has been elevated in the past year as the unemployment rate settles at a 17-year low.

Europe

Robust Growth in Europe

The euro-zone's annual economic expansion rate recorded its optimum year since the great financial crisis and outperformed that of the United States in the third quarter of 2017. The German economy was a major contributor to the latest GDP figure, while the convergence of growth rates among euro-zone countries was also a factor. Looking at the components of growth, net exports made solid contributions, whereas domestic demand might have eased a bit from recent strong growth rates. In details, the second estimate of GDP data point out that the euro-zone economy swelled 0.6% in the third quarter 2017 and 2.5% in annual terms.

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The big news was the robust growth in Germany that continues to head north for 13 consecutive quarters, marking the longest streak since 1996. The economy accelerated at a rate of 0.8% for Q3 2017, beating an estimate of 0.6% and rising higher than the 0.6% recorded in Q2. The core drivers for growth were net exports and fixed business investment. On a yearly basis, the economy grew by 2.8% in the third quarter. Looking at the macro picture, the Germany environment is favorable in terms of price growth that slowed to 1.6% in last month. With low-interest rate, low unemployment rate, and low inflation atmosphere are predominantly encouraging for private consumption. Taking into account the upward revision of Q1, stronger than expected Q3 growth, corporate and consumer leading indicators near record highs point to a robust economy. The latest readings on the European economy are in line with the ECB's decision last month to start tightening the euro zone off ultra-loose money by saying that from January it will cut the amount of bonds it buys every month to 30 billion euros. It nevertheless promised years of stimulus and left the door open to do a U-turn if necessary.

Subdued Inflation Persists

The latest data on price acceleration confirms the theme of subdued core inflationary pressures in the euro-zone and supports the Bank's view that monetary accommodation will be removed very slowly. On annual terms, consumer inflation deflated by 0.1% to 1.4% for October and there was a sharp drop in the core rate, from 1.1% to 0.9%, the lowest since May. The reduction in the core rate is mainly attributed to services inflation, which declined from 1.5% to 1.2% year on year. ECB's president Draghi might be pleased to have retained scope to do more in case inflation turns out weaker than the ECB expects and support the outlook that monetary accommodation will be removed very slowly.

Negative Real Wages Stings UK's Retail Sector

The ongoing theme of low unemployment rate and frail wage growth continues to loom over the British economy. The unemployed rate remained constant at 42-year low of 4.3%, while earnings including bonuses rose 2.2% annually, down from 2.3% seen in August. That leaves wages lagging behind inflation, which remained at a five-year high of 3.0% in September and October.

Looking at employment growth, there were 8.88 million individuals aged between 16 to 64 who were economically inactive in September and the figure is 117K higher than in April-to-June period. The UK economy has shed 225K jobs just over the past two months. The recent softening in the data might reflect the economy's weakness as it faces a real income squeeze and continued Brexit-related uncertainty. If this trend continues, it might chip away at the case that rates need to rise further in order to ease inflationary pressure from tightness in the labor market.

Both headline and underlying annual inflation remained stagnant in October at 3% and 2.7% respectively, wrong-footing the Bank of England's prediction that inflation would hit 3.2%. On the producer front, factory gate prices increased 2.8% year on year, down from 3.3% recorded in September. The downward movement is attributed to lower energy costs.

The central bank believes departing from the EU will dampen UK's capacity to grow as fast as before without producing excess price growth, and with the lowest unemployment rate since 1975 creates labor shortages and a recovery in wage growth is seen as a risk. Moreover, inflation may pick up strongly next month due to rising oil prices. The BoE is unable to make clear predictions about Britain's future due to the Brexit uncertainties.

Continuous series of negative real wages in UK's labor market and uncertainty on the future outlook has caused the retail sector to record its first yearly decline in four years. The decline was less severe than predicted earlier and data reviled that the sector shrank 0.3% annually in October. Moreover, sales in the three months to October were just 1.1% higher than the year before, the weakest growth rate since May 2013. It's been a tough year for retail sales as real wage growth hasn't shown any room for improvement. The CPI may not go much higher from the current 3% level, but the BoE and analysts anticipate that consumer inflation to return to normal levels will take at least three years

Asia

Government Crackdown Takes its Toll on the Economy

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The government's effort to control the high degree of financial leverage and air pollution began taking its toll on the economy. All three key monthly economic indicators (industrial production, fixed asset investment and retail sales) declined significantly from September's reading and all were below market expectations. Industrial production came in at 6.2% year on year for October, reflecting a drop of 0.4% from the previous month. Retail sales also dipped from the prior month by 0.3% to 10%.

The moderation in economic data for the month of October stipulates that growth slowed and may continue its momentum in the quarters ahead as the government persists on its economic crackdown. While the size of the slowdown surprised markets, the National Bureau of Statistics quoted "economic growth remains in a reasonable range." A number of forecasters assume that even with some loss of momentum in the fourth quarter, China's economic growth might easily meet or beat the government's full-year target of around 6.5% due to the fact that Beijing would not risk a sharp slowdown in growth through its debt and pollution restriction given the government's major focus on creating jobs and adopting social stability. Overall, markets expect weaker trade and activity figures in the coming months as the Chinese government intends to strike a balance between growth, debt and regulation.

A Weaker Yen Supports Growth

The Japanese economy persists on growing as the latest data indicated. The economy advanced at an annualized rate of 1.4% in the third quarter, the longest streak in 16 years, though the pace of expansion slowed from the previous quarter. Exports were the main engine of expansion in Q3, supported by a weaker yen alongside with rising global demand, which helped offset a dip in consumer spending. Moreover, the unemployment rate is at multi-decade low combined with negative interest rates also played a role in contribution to GDP.

As for the global recovery ranging from the US through Asia to the European Union, helps Japan's exporters tremendously. Earnings at major Japanese companies have soared, share prices followed, hitting multiyear highs as global economic growth has become more broad-based.

Kuwait

Kuwaiti Dinar

The USDKWD opened at 0.30200 on Sunday morning.

Rates – 19th November, 2017

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.1657	1.1621	1.1860	1.1793	1.1580	1.1885	1.1863
GBP	1.3170	1.3060	1.3259	1.3211	1.3020	1.3320	1.3255
JPY	113.58	111.93	113.91	112.07	110.05	114.20	111.52
CHF	0.9962	0.9845	0.9986	0.9884	0.9695	1.0095	0.9816

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