Treasury Group

Weekly Money Market Report

28 January 2018

NBK الوطني

US Dollar Weakness Dictates FX Market

United States

Equity Markets Unaffected by US Government Shutdown and Revival

After the first government shutdown since 2013, Congress passed a bill to reopen the government last week until February 8th. The deal struck between the two parties had a damaging impact on Democrats after accusations from their leftwing sector caused a disunion within the party as it heads into the 2018 midterms and is the first significant split in the Democratic group since Donald Trump took the Presidency. Interestingly, unlike the shutdowns in 1996 and 2013, the stock market displayed no negative reaction. The S&P was at fresh record highs on the eve of the shutdown, most likely because it is not expected to last as long. The 1996 and 2013 shutdowns lasted more than 2 weeks.

Reuters poll of over 500 economists suggested that the world economy is expected to expand at a strong pace this year and reach a level not witnessed in eight years as momentum builds in developed economies and inflation comes back to life. Major policymakers are anticipated to deviate from their loose monetary policy this year, while funding costs are still accommodative and should support growth. Meanwhile, the global economy is predicted to grow 3.7% this year, the fastest since the 4.3% recorded in 2010.

On the currency front, the US dollar index has depreciated sharply by around 3.6% since the start of the year, which comes on top of last year's sharp decline of nearly 10%. As a result, the DXY has now almost overturned two thirds of its advances which took place between 2014 and 2016. Worries over a shift to protectionist trade policies under President Trump and a desire for a weaker US dollar by the Treasury Secretary have enhanced the sell off early this year. The USD index reached its lowest level in three years last week at 89.067.

The single currency appreciated tremendously against the US dollar throughout last week, supported by USD weakness, robust EU data and an optimistic picture of the future painted by ECB's President Mario Draghi. The EUR/USD soared to more than a three year high of 1.2536 last Thursday. The pair managed to close the week higher by 1.42%.

As for the Sterling pound, the currency has been one of the best performing global currencies so far this year. The strength has been driven in part by a further reduction in the Brexit risk premium and building expectations that the BoE could be moving closer to raising rates again this year. It was also a favorable week in terms of economic data from the UK, combined with the dollar feebleness the GBP/USD rose to the highest level since June 2016. The GBP/USD closed the week at 1.4168 and gained 2.08% over the USD last week.

At the start of last week, the Japanese yen strengthened after the BoJ turned slightly optimistic over the country's inflation outlook. The USD/JPY fell to the lowest level since September 2017 last week and the USD lost nearly 3.5% of its value to the yen since the start of the year.

On the commodities front, the precious yellow metal ascended to a 17-month high on Friday to $1,366.00 an ounce. Gold extended its gains after US Treasury Secretary said he welcomed a weak Dollar. Advancing for the 12th time in 18 trading days this year, the price of gold has risen around 3.7%.

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Lower Housing Supply Dampens Demand

The US housing sector took a hit after existing and new home sales declined last month. Existing home sales, which account for around 90% of housing sales fell 3.6% to a seasonally adjusted annual rate of 5.57 million as the quantity of houses on the market dropped to a record low, pushing up prices. In annual terms, the existing sector still managed to rise by 1.1%. In regards to price movement, the average house price increased 5.8% annually, which was the 70th straight month of year-on-year price gains. As for new home sales, Americans cut back their purchases of single family homes as the recent improvement from the replacement of flood-damaged houses began to fade and harsh winter weather dampened demand. Sales tumbled 9.3% in December, although in annual terms sales were up 14.1%.

Forty-four percent of homes sold in December were on the market for less than a month due to the pace of demand in an environment of a strong labor market that has unleashed demand for housing. As a result, house price inflation has overshadowed wage growth. Mortgage rates are projected to head north as the US central bank is expected to hike three times this year, somewhat forcing home buyers to lock in their mortgage rates. A separate report from the Mortgage Bankers Association showed that applications for home loans surged last week to their highest level since April 2010. Markets believe supply will remain tight, which together with rising mortgage rates could result in modest home sales growth for the current year.

US GDP Misses Estimate

Consumers in the US supported the economy in the last quarter of 2017, but declining inventories and a wider trade deficit overshadowed consumer’s contribution to GDP. The economy expanded at rate of 2.6%, well below the 3% expected by markets. Even though the headline GDP growth rate was less than expected in Q4, the underlying data suggest that the foundations for continued above-trend growth are still in place. Importations descended 0.7% in Q3 and then surged 13.9% in Q4. Quarterly swings in imports could be less pronounced going forward. Indeed, a likely slowdown in the growth of imports in the current quarter will probably be positive for GDP growth at the start of the year. As for inflation, PCE was up to 1.7% in 2017 from 1.2% in 2016. Core PCE moved in the other direction, sinking to 1.5% from 1.8%. Core inflation is generally a better indicator of longer run inflation trends. The GDP data did not give any indication that core inflation is about to break out of the narrow 1.3% to 1.9% range of the last five years.

Europe & UK

ECB Maintains its Stance

The first policy meeting of the year showed that the ECB maintained its language on monetary policy by restating that the Bank stands ready to further loosen monetary stance if the outlook becomes less favorable. In details, the ECB preserved its policy rates with the main refinancing rate, the marginal lending rate and the deposit rate residing at 0%, 0.25% and -0.40% respectively. Highlights of the meeting included Draghi stressing the point that key policy rate will remain constant well past the end of QE and that the current state of economic data holds an extremely slim chance for a rate rise this year. Furthermore, central bank stated that current impulsiveness in the exchange rate represents a source of uncertainty that necessitates monitoring. On the positive side, the ECB mentioned that the pace of economic development has exceeded expectations in the second half of 2017 and this had further reinforced the Bank’s confidence that price growth would return to target.

Overall, the dovishness outweighed the hawkish words on accelerating growth and this supports the fact that the market might be pricing in tightening too quickly. The ECB President said several factors are still not in line with our strategy, core inflation isn’t indicating any convincing signs of upward movement, pipeline price pressures are stable and subdued, wage negotiations haven’t produced much and survey measures of inflation expectations are broadly

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unchanged. Under their current forward guidance, the first planned rate hike seems to come to life in 2019 as perceived from Draghi's comments.

Euro-zone Momentum Persists

The euro-area composite PMI continues to suggest robust economic momentum and a recovery that is in full throttle. The euro-zone composite PMI increased to a 12-year high as the index rose by 0.5 points to 58.6. In terms of the details, the single economy witnessed a decline in the majority of manufacturing sub-indices, such as for employment and new export orders. However, it was a different story for the service sector, there was an enhancement across the board in employment and business expectations.

The manufacturing survey retreated from a record high, while the services survey continued its northern momentum. This indicates that the recovery is largely due to a strong domestic demand as well as strong demand from abroad. If the recent appreciation in the euro does begin to negatively impact euro-zone exports, strong domestic spending could continue to be a key driver of the overall recovery. The economic progress is unquestionably solid, and there are signs of that strength leading to higher underlying inflation. Manufacturing input prices were inflated in January due to an increase in oil prices. But it is also notable that the services output price index, one of the preferred measures of domestically-generated inflation, has risen to its highest level since August 2008. IHS Markit pointed out that, while higher oil prices were part of the story, the rise also reflected improving pricing power as demand outpaced supply.

Consumer sentiment ascended to a near-record high this month thanks to robust economic data from the single currency area. The sentiment index of the euro-area increased 0.8 points to 1.3 and is well above the long term average. The index is within touching distance of its previous peak reached in 2000. The latest data indicates that the European momentum still has room to move north and continuous spending advancements increases the probability that the pace of expansion in Europe may persist. The same trend in economic confidence was seen in Germany for the month of January. Economic sentiment was elevated to eight months high and the assessment of present situation hit an all-time high. The German ZEW confidence index improved 3 points to 20.4 and the current assessment index added 5.9 points, coming at 95.2. Most importantly price growth index expectations in the euro-zone progressed to 57.5, up by 11.3 points.

German Business Confidence at Record High

The economic status in Europe's largest economy remains optimistic as Germany's business confidence progressed to a new record high. The Ifo Business climate surged in January by 0.4 points to 117.6, the increase was driven by current conditions, which also jumped to new record high of 127.7 from a revised 125.5 in December. On the other hand, business expectations for the next six months were slightly scaled back. The indicator retreated to a 4-month low of 108.4 from 109.4 a month ago, which was the second retreat in a row. The continuous fall in expectation outlook may suggest that the peak in momentum might be close.

The latest data signaled that the current political gridlock in Berlin isn't really impacting German business moral and momentum. Last week's rise in the euro-zone PMI reached its highest reading since 2006, telling us that the German economy is likely to benefit from the continued and broadening recovery in Europe. The German outlook still looks bright, but risks still reside over the economy. German exports might be relatively immune to an appreciation of the euro but that might change if recent upward momentum in EUR-USD continues. Moreover, risks to the economy are external, especially in the form of US tax reforms and the threat of rising protectionism around the globe.

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British Employment Rebounds

UK's employment figure was an important factor to look into last week, given the pull down in the last couple of months, which suggested some loss of momentum in the labor market. Employment growth in the UK expanded by 103K in the three months to November after two consecutive weak readings and added a robust 415k jobs in the year to the end of November. The unemployment rate was constant at a 42-year low of 4.3%. As for the wage growth, basic pay increased 2.4% from an earlier reading of 2.3%, while wages including bonuses remained unchanged at 2.5%. Even with the slight rise in wage growth, real wages are lower than the previous year as consumer inflation hovers around 3.1%.

Chris Williamson, chief business economist at IHS Markit, said the figures showed the UK labor market displayed signs of strength late last year, with employment rising and pay growth "creeping higher". Pay expansion nevertheless remains below price growth, pressuring consumer spending and household's views on their financial wellbeing in January. Under such conditions, it seems that the recent disappointing consumer spending trend will persist into 2018, restraining economic growth. The BoE will announce its next policy decision on February 8, alongside new growth and inflation projections.

UK's GDP Higher than Expected

In the last quarter of 2017, the preliminary reading revealed that the British economy was enlarged by 0.5% versus an expectation of 0.4%. The economy grew 1.8% in 2017, down from a rate of 1.9% in 2016, and the slowest pace of annual growth since 2012. The acceleration in the fourth quarter was attributed to an expansion of 0.6% in the country's dominant services sector. Manufacturing also had a strong quarter, rising by 1.3% on the back of a weaker currency, strengthening global and euro-zone economy, which has boosted UK exports. In spite of a slight upward movement in GDP, the underlying picture is of slower and uneven growth across the economy. British citizens have been under pressure throughout last year as prices have risen faster than wages. In regards to the BoE, the GDP reading is good news for board members as they prepare their forecasts on inflation for the 8th of February known as Super Thursday. During the December meeting minuets the committee believed that GDP will come in below 0.4%. So, growth has come in at 0.2% higher than they had expected, alongside the strong November job growth numbers that came out last week. These factors may support the view that the BoE may hike in May, however the market implied probability of this is still just 40%.

European Growth Assists Britain's Budget Deficit

Britain's budget deficit shrank to the lowest level in 17 years for the month of December after robust growth in the euro-zone led to a discount from the bloc. The single currency area's budget has been recalculated to reflect new economic estimates and lower spending, elevating the assistances from euro-zone countries and reducing the UK's payments. The decrease in the deficit is attributed to a credit from the EU in the amount of GBP 1.2 billion as the UK paid GBP 700 million to Brussels last month and got GBP 1.9 billion back. Moreover, inflated government tax receipts reached their highest level on record last month, while taxes on income and wealth rose 4.3% compared to December 2016.

In details, net public borrowing in the current financial YTD contracted to its lowest level in 10 years coming at GBP 50bn compared to GBP 56.6bn in the previous fiscal year. Public sector net debt fell by GBP 26.8 billion to just under GBP 1.6 trillion. The data increases the probability that Chancellor Philip Hammond could meet the deficit target this year, however the government's debt is still too high as it accounts to 77.2% of UK's GDP.

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Asia

BoJ's Dilemma

The BoJ maintained its monetary settings last week and painted a more upbeat picture on price growth than the previous quarter, indicating that the Bank's perception on inflation will gradually push towards the 2% target around the fiscal year ending in March 2020. The BoJ stated that the economy is projected to expand moderately and it will maintain its extremely loose monetary policy as long as needed to reach the inflation target. The BoJ Governor claimed he saw no immediate need to tighten monetary policy.

Looking at the economic data, the economy grew for seven continuous quarters, the longest uninterrupted stretch of growth since 1994 and stock prices are at their highest in 26 years. Japan's core price growth has been on the rise for 12 consecutive months in December, but the index failed to add any additional upward movement from the prior reading. Core inflation remained constant at 0.9% annually, while Tokyo's core inflation index slipped by 0.1% to 0.7%. However, households expecting inflation to accelerate hit a nearly two-year high in January. Overall, the perception that inflation in Japan will remain low has decreased significantly and if rates are rising in the US and Japan's economy is doing well, there will be some upward pressure on rates. The monetary meeting was a remainder to markets that the BoJ is in no urgency to follow the path of major central banks that are currently in hawkish modes. This leaves the BoJ in a dilemma on how to taper its loose monetary strategy that even some of its own board members warn will begin to negatively impact more than assist if retained for too long, while inflation isn't halfway to the bank's target.

Kuwait

Kuwaiti Dinar at 0.29960

The USD/KWD opened at 0.29960 on Sunday morning.

Rates – 28 January, 2018

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	High	Low	Close	Minimum	Maximum	Forward
EUR	1.2258	1.2536	1.2212	1.2419	1.2315	1.2625	1.2496
GBP	1.3887	1.4344	1.3855	1.4168	1.4055	1.4350	1.4220
JPY	110.62	111.22	108.27	108.70	106.70	109.65	108.15
CHF	0.9613	0.9639	0.9290	0.9335	0.9140	0.9435	0.9275

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