Treasury Group
Weekly Money Market Report
06 August 2017

NBK الوطني

The European Momentum Continues

United States

Non-Farm Pay Roll Comes to the Rescue

Over the past several months US economic indicators have been coming in below market expectations, which were elevating the likelihood for the Fed to change its monetary trajectory. However, after the release of the robust jobs report, the data strengthened the case for the central bank to tighten its monetary stance as it claimed it would earlier in the year , especially when the Fed set a low and gradual bar for balance sheet normalization to begin in September.

When the robust Non-Farm reached the market, prices of US government debt fell and US equity indices embraced the news. The latest jobs report for the US economy appeared to tick all the boxes when the figures were released, favorable job gains, lower unemployment rate and a higher participation rate. But as always, there was one crucial component missing.

Earnings have been below historical levels since the global financial crisis, despite ongoing jobs gains for almost a decade. Earnings did rise by 0.3% for the month, however on an annual basis the momentum has been relatively steady at 2.5%. The jobs report is mostly a historical indicator on the US economy, while PMI figures indicate future growth prospects. We have been witnessing slower growth in PMI data for the US, but in the eurozone markets are seeing better numbers of PMI indicators.

On the global outlook, conditions are improving and labor markets have tightened even more and above-trend growth is expected in a number of advanced economies. Although, low growth in wages seems to be a global risk in most countries. Headline inflation rates have declined recently, largely reflecting the earlier decline in oil prices. The IMF has raised its growth expectations for China and the euro zone, while trimming those for the United States and Britain. The Fund said the euro zone's recovery was firming and becoming broad-based, with stronger domestic demand.

On the currency front, the Dollar started the week on a downward trend and touched a 15 months low at 92.548 on Wednesday. The greenback has been pressured on many fronts by political tension in Washington, uninspiring economic data and especially sluggish inflation, which is adding to uncertainty about the pace of future Federal Reserve policy tightening. Moreover the DXY was further subdued when communications director Anthony Scaramucci was fired last week after only 10 days since his appointment by the President. Scaramucci was the 7th senior White House official to be let go in the six month. In the end of the week, the DXY was on track for a fourth consecutive weekly loss, however that all changed after the strong jobs report. The DXY rebounded from 92.776 to 93.774, a 1% gain. The index closed the week at 93.542

The single currency began the week on a positive tone after the eurozone core CPI rose to a four-year high. The EUR/USD kept its momentum and on Wednesday the pair rose to 2.5 years high as the US private sector employment report failed to inspire the market. On Friday, the pair toke a turn after the US nonfarm payroll supported the Dollar. The EUR/USD depreciated 1% due to the data. The pair opened the week at 1.1758 and ended the weekly session at 1.1768.

The sterling pound took a beating last week as markets perceived the BoE’s tone as dovish, when the bank cut its growth and wages forecasts. The Sterling Pound has been appreciating recently due to the weakness in the Dollar. When the Non-Farm payroll came out, the GBP/USD continued its downward trend. The Sterling pound closed on Friday at 1.3035 and was down by 0.85% for the week.

The Japanese Yen opened the week at 110.63 and rose to a weekly high of 111.04 on Friday after the positive US jobs report reached the market. The pair managed to close 4 points higher at 110.67 in what proved to be an uneventful week for the currency.

The Swiss Franc ended the month as the only major currency not gaining any ground against a sluggish US Dollar. The Swissie also ended the month of July down 4.7% against the Euro, its biggest monthly fall since 2011. Several analysts, viewed last week’s sharp fall as a “catch-up” for the franc, which had been holding its level against the euro

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despite the latter's significant gains against other currencies, particularly the dollar. USDCHF opened the week at 0.9688 and managed to close the week at 0.9727.

In the commodities complex, the price of oil was elevated at the start of last week as investors weighed the potential for the US to impose sanctions against Venezuela. This could result in a shortage of oil inventories given that Saudi Arabia is already shipping less oil to the US. The price of Brent crude oil rose to $53.35, the highest since late May and ended on Friday at 52.98.

A Robust Labor Market

The American economy created 27,000 more jobs than expected coming at 209,000 and employers paid higher wages for their employees In July. June's employment gain was revised higher by 9,000 to 231,000. The jobless rate ticked lower again to a 16-year low from 4.4% to 4.3%. US earnings a key component of the jobs report rose 0.3% after rising 0.2% the previous month, however on an annual basis the rate remained changed at 2.5%. That's below the 3.5% to 4% that is typical when the unemployment rate is this low.

Overall, the figures indicate that employers remain optimistic about their businesses and future consumer demand. The gains may fuel higher spending by US citizens, which accounts for two-thirds of the economic activity. Although, employers are still hiring at a strong pace, suggesting employers have plenty of workers to choose from and won't have to raise pay. The is an issue for the Fed because they have raised short-term interest rates three times in the past seven months, based on the idea that employers will soon have to pay more to attract workers

US PMI Indicators Grew at a Slower Rate

The Chicago Business Barometer kept on expanding for the month of July, however the index has cooled down from earlier in the summer. The Chicago PMI fell from June's 65.7 to a three months low of 58.9 as new orders index declined by 11.6 points to a 5-month low, while the production index retreated 6.9 points.
In a separate survey, 70% of companies in the last year claimed that they have increased the pay for their employees. Yet a majority of firms still aren't increasing wages as much as they normally would when the unemployment rate is near a 16-year low at 4.3%. The index remains optimistic even as much of the president's agenda, including tax cuts, deregulation and a boost to infrastructure spending have stalled. All the components of the index retreated last month but remained above their respective 12-month averages.

In the manufacturing sector, the pace of growth expanded in July, but at a slower rate than the previous month. The ISM Manufacturing Index descended to 56.3 from 57.8 due to a slowdown in the components of employment and new orders. So far in 2017, the index has averaged a reading of 56.4, significantly better than the 51.4 average two years ago. The service sector also grew at a slower rate in July, following the same momentum as the manufacturing industry. The non-manufacturing indicator was knocked down 3.5 points to 53.9 versus an expectation of a rise to 57. Focusing on the sub-components of the service sector, the business activity index contracted by 4.9 points, while new orders shrank by 5.4 points.

Inflation Remains Subdued

A closely watched indicator on US inflation by the Federal Reserve (PCE) was lower in June as spending on fuel decreased due to falling oil prices. Year to year, the PCE index rose 1.4%, down from May's 1.5% reading, well below the 2.2% seen in February. Excluding food and fuel price changes the core PCE remained flat at 1.5%. The recent inflation figures further reduce the chances that the central bank will elevate interest rates again this year and the likelihood of a hike in December is around 30%. The US economy should benefit as the dollar index has depreciated nearly 10% since the start of the year by generating higher inflation, but with wage growth remaining subdued the market continues to doubt the prospect of meaningful rate rises from the Federal Reserve.

Europe & UK

Further Evidence of Robust European Momentum

The ECB'S preferred indicator on inflation Core CPI rose to four-year high, while headline inflation remained flat. The Flash Core CPI increased by 0.1% to 1.3% against an expectation of a drop to 1.1%. The latest figures on price

growth validates the ECB's statement that deflationary risks have disappeared, however the latest figures remain well below the ECB's target of 2%.

On the employment front, the eurozone unemployment rate in June declined to the lowest level since February 2009. The jobless rate fell to 9.1% from the 9.2% recorded in May. On an annual basis, the unemployment rate dropped 1% as growth in Europe has been supported by a low interest rate environment. Europe's largest economy recorded the lowest unemployment rate at 3.8%, the lowest rate since the post-reunification era. On the outer edges of Europe, the jobless rate remains far from the rates recorded before the financial crisis, suggesting there still is room for improvement in the labor force. Overall, the prospects of higher wages have increased since the rate of unemployed citizens in the labor force fell to multi-year lows and consumer inflation soared to 4 years high.

The first estimate of growth for the single block economy is expected to advance at a rate of 0.6% in the second quarter, from 0.5% recorded in the first quarter. Year on year, growth is projected to expand at a rate of 2.1% from 1.9%, the best level in five years. The latest numbers reinforces the view that economy continues to accelerate after two years of massive asset purchases by the ECB and almost 1.5 years of negative interest rates. The economy has now expanded for 17 consecutive quarters. Looking at the big picture, the economy is performing pretty well compared to the rest of the world, which strengthens the case for the ECB to taper its asset purchases next year.

In Germany, shopper's confidence in spending was elevated in June helping retail sales to its best monthly gain since October 2016. On a monthly basis, retail sales increased 1.1%, from May's 0.5%. The German economy has been assisted by a record low unemployment rate, which added 657K jobs between June 2016 and June 2017. Consumption has overtaken exports as the main driver of growth, supported by a robust labour market and low interest rates. The latest data on retail sales will reinforce a set of economic and business surveys from the German economy, which have all pointed to a robust end for the second quarter.

One More Dovish Member on the MPC

The BoE's Monetary Policy Committee voted 6-2 to hold the Bank Rate at a record low of 0.25% and its asset purchase target at GBP 435 billion. Compared to the June meeting, the vote split was 5-3 due to the hawkish member Kristin Forbes, who has been replaced by Silvana Tenreyro a more dovish MPC member. The BoE anticipates a 1.7% increase by year-end and 1.6% for 2018. Both figures were revised down from prior projection of 1.9% and 1.7% respectively. Wage growth expectations were also trimmed down by 0.5% for 2018 and 2019, however no major changes were made for inflation expectations.

BoE Governor Carney stated "It is clear that Brexit uncertainties are weighing on the decisions of some business. We see it directly in the macroeconomic numbers, investment has been weaker than we otherwise would have expected." Moreover, a series of surveys for Britain's manufacturing, construction and services sectors published last week suggested the economy remained in a low gear in July and recent figures have shown the economy had its slowest growth since 2012 in the first half of this year. Looking at the yield curve, the bank expects just two hikes over a three year horizon. The bank's monetary policy is likely to remain data dependent and future economic indicators may remain subdued as consumer's real income continues to shrink and firms wait for more clarity on the Brexit process.

Mixed Signals from UK's PMI Figures

British manufacturers recovered from a 7-month low posted in June as export orders soared to the highest in 7 years. The Sterling's depreciation since the vote to leave the EU appears to be providing significant support for manufacturers by boosting external demand. On the other side of the lever, output growth in the investment and intermediate goods sectors hit its lowest in eight and five months respectively. The manufacturing index rebounded from 54.2 to 55.1, however the index remains below the average seen in the first half of the year at 55.3.

Growth in Britain's construction sector eased last month to the lowest level since the vote to leave the European Union. The sector has been pressured on several fronts from political uncertainties due to Brexit, investors' appetite to invest in the economy and a rise in material prices. The construction index came in at 51.9, from 54.8 in June. Lower levels of commercial constructions were a key factor holding back the sector, which contracted from 52.5 to 47.6. The prices for construction materials increased at one of the sharpest rates since the first half of 2011, generated by a weaker currency. The survey indicated that businesses and investors cited delays in decision making, mainly associated to worries about the economic outlook and heightened political uncertainty. The Office for National Statistics estimated that the sector shrank 0.9% in the second quarter of 2017.

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In the service sector, business activity improved gently in July from a four-month low recorded in June, but the rate of expansion remained relatively subdued. The start of new business was one of the weakest seen since last autumn. Meanwhile, staff recruitment continued to gain traction, reaching its strongest pace since the start of 2016. Input costs remained strong in July, driven by rising food prices, energy bills and salary payments. Hence, operating expenses led to the fastest increase in average prices charged by service sector firms in three months. The index edged up by 0.4 points to 53.8. The three PMI surveys are broadly consistent with economic growth of just over 0.3% in the second quarter of 2017.

Asia

Global Demand Weighs on Chinese & Japanese Manufacturers

China's manufacturing sector grew for the 12th consecutive month, however the pace of growth was slower in July. The slower momentum is attributed to weaker demand for Chinese goods globally. The manufacturing index fell by 0.2 points to 51.4 as new export orders slipped to 50.9 from June's 52.0. The sector has been supported by investments in construction that has fuelled demand for everything from cement to steel and other building materials. The construction index rose to a three-year high in July as the Chinese economy invests in infrastructure. In the services sector, growth also expanded at a slower rate, falling from a three-month high of 54.9 in June to 54.5. Economic growth may ease in coming months as the government adopts stricter financial regulation, which may increase the cost of borrowing for businesses.

In Japan, the manufacturing sector in July expanded at the slowest rate in eight months as export demand weakened. The final reading for new exports declined by 2.5 points to 50.9. On the domestic front, new orders did not soften as sharply, which assisted to offset the weakness in overseas demand. Despite the softer data, the PMI index remained above the 50 threshold for the 11th consecutive month, indicating 11 consecutive months of growth. Data provided by the government showed that businesses expect output to accelerate back in August, giving hope that industrial production will continue to expand at a healthy pace. The manufacturing PMI fell to 52.1 from June's 52.4. Overall, Japan's economy is expanding at a modest pace, the labor market is tightening but inflation remains far from the BoJ target.

A Strong Aussie affects the Australian Economy

The Reserve Bank of Australia kept its benchmark rate unchanged as expected at a record low of 1.5% as the economy wrestles with a strong currency and weak inflation. The AUD has appreciated recently due to the weakness in the US dollar, which has increased the probability of subdued price pressures and may negatively impact the country's export demand. There were no major changes in the bank's future expectations for the economy and the RBA predicts that the economy will expand at an annual rate of around 3%. The RBA's Governor Philip Lowe said "We are intent on delivering Australians an average rate of inflation over time of between 2 and 3%. We are seeking to do this in a way that supports sustainable growth in the economy and that best serves the public interest."

Employment growth has been stronger over recent months, and various forward-looking indicators point to continued growth for future employment. Against this, wage growth remains low and household debt is already at 190% of disposable income, which could limit consumer spending.

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Kuwait

Kuwaiti Dinar at 0.3190

The USDKWD opened at 0.30190 on Sunday morning.

Rates – 06 August, 2017

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.1735	1.1721	1.1909	1.1768	1.1660	1.1200	1.1831
GBP	1.3129	1.3021	1.3264	1.3035	1.2940	1.3230	1.3079
JPY	110.63	109.82	111.04	110.67	108.95	111.65	110.22
CHF	0.9688	0.9630	0.9763	0.9727	0.9540	0.9900	0.9673

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