Treasury Group

Weekly Money Market Report

19 March 2017

The Fed Delivers a Dovish Hike

United States

Markets Expected a Hawkish Yellen

In a highly anticipated move, the FOMC raised interest rates last week pushing fed rates to a range of 0.75 to 1%. With only two more rate hikes expected this year, and despite the fact that hiking interest rates tightens monetary policy and reduces liquidity, markets took it as the greenlight to extend the rally despite moving on only hopes of accelerated corporate earnings accompanied by falling oil prices, higher borrowing costs, and a strong US dollar.

In a volatile reaction to the less aggressive Fed comments, equities rose, bond yields fell, and the dollar tumbled as investors digested Yellen's remarks and chased an already extended bull market cycle.

During the press conference, Yellen mentioned that the economy continues to grow moderately, with the labor force expanding at an average of 200,000 a month. Fed officials also kept 2017 growth projection at 2.1%, but increased 2018 estimates by 0.1% to 2.1%. Longer-run growth estimates remained at 1.8% while the personal consumption expenditure index now stands at 0.1% away from the Fed's target of 2%.

On the economic front, global activity gained momentum as the accelerating inflation in other blocks such as the Euro zone has increased the probabilities of higher rates globally. With monthly PMI data reporting improving global activity, investors feel a greater degree of confidence about the world economy since the beginning of the year.

In a parallel move, global Central Banks responded to the Fed hike by raising their respective interest rates. China raised its short term interest rate, as well as Central Banks in Saudi Arabia, the United Arab Emirates, Kuwait and Bahrain tightening their monetary policies.

On the currency front, the US dollar index started the week at 101.24 and appreciated to a high of 101.79 as speculation of a March rate hike fueled the buying spree. However, the index reacted negatively to the dovish message as investors expected the central bank to reveal a more hawkish stance towards more interest rate hikes this year. The Index tumbled to a low of 100.16 and ended the week at 100.30.

The Euro had a more positive week despite the rising interest rates differential compared to the USD. After depreciating to a low of 1.0597, the currency reversed it losses on the back of the Netherlands elections results where the outgoing Dutch Prime Minister Mark Rutte managed to win more seats than the populist politician Geert Wilders. With the currency trading mostly on the back of political uncertainties, the defeat of the populist front had a more positive impact than the FED's hike. The pair reached a high of 1.0782 and closed the week at 1.0738.

The Japanese Yen opened on Monday at 114.87 and traded in a narrow range until Thursday's Bank of Japan meeting. Although Governor Kuroda said that an uptick in inflation towards 1% will not immediately trigger an interest rate hike, markets interpreted the news as the BoJ backing away from the extreme monetary policy that Japan pursued during the past couple of year. USDJPY dropped to a low of 112.57 to end the week at 112.70.

On the commodities front, having witnessed increasing prices throughout the past six months despite the global bleak demand compared to the increasing supply, oil prices were under heavy pressure at the start of last week on concerns those supplies have outweighed demand.

With the Fed delivering a dovish hike and after US crude oil inventories fell to a 10-week low, crude prices changed momentum and closed the week at $48.78.

Mixed US data Continue to support gradual Fed hikes

Wholesale inflation continues on the rise increasing by 0.3% in February on the back of rising services costs. On a yearly basis, producer price index jumped 2.2%, the strongest reading since March 2012. Excluding energy and food, PPI rose by 0.1% to 0.3%.

In parallel, consumer's inflation rose at the fastest rate in five years moving up by 0.1% in February, placing the yearly inflation growth at 2.7%. The rise in CPI was mainly attributed to higher energy prices, housing costs, and prices of medical treatment.

Core CPI has also been on the rise since February 2015 and continued to edge up in February by 0.2% after a 0.3% gain in the previous month. Yearly, core CPI increased by 2.2% in February.
The latest data continue to point to higher inflationary pressure not just due to higher energy prices but also in a sign of a stronger economy.
On a different front, US consumers decreased their spending in the month of February and recorded their smallest gain in six months. According to analysts, the delay in tax refunds and rising inflationary pressures were the main reasons for the weak retail spending in February.
In summary, retail sales came in line with expectations of 0.1%, while core retail sales expanded 0.2% versus expectations of 0.1%.

Last but not least, the Federal Reserve Bank of Philadelphia's monthly outlook index on regional manufacturers has gained positive momentum for 8 consecutive readings and remains relatively high. The index in March dropped from a 33 year high of 43.3 to 32.8 versus a forecast of 30. The survey showed 44% of the businesses suggest further expansions in activity, while 11% reported decreases in business activities. The Philly Fed stated the survey's future indicators continued to improve and indicates strong optimism about future growth in manufacturing.

Europe & UK

Despite a Spike Up in Headline Inflation, the Core Remains Weak

The Eurozone final estimates of annual CPI came in at 2% in February, up from 1.8% in January. This compared to last year's figures at -0.1%. The jump in costs was largely due to higher energy and food prices. In details, oil prices account for 60% of the increase, while food costs account for 25%. On the core front, excluding food, energy and tobacco, annual inflation held at 0.9% for three consecutive readings. The ECB concluded that inflation was still weak and there was still no evidence of a sustained increase in inflation data.

Political Uncertainty Clouding Germany's Outlook

Germany's economic outlook in the month of March slightly improved, however missed market expectations. In details, the ZEW Indicator of Economic Sentiment rose by 2.4 points to 12.8 in March well below the long term average of 23.9 and the expected level of 13.0. In addition, industrial production and exports witnessed a positive development while figures for incoming orders and retail sales were less favorable.
In summary, data continue to show a mix picture in Europe as the political uncertainties resulting from the upcoming elections in Germany, France, and Italy have been clouding consumers' sentiments.

The UK starts to feel the "Brexit "effects"

As the UK develops its plan to leave the European Union, the unemployment rate fell by 0.1% to 4.7% in February, marking the lowest level since 1975 and employment remained steady at a record of 74.6%. In addition, the number of citizens claiming jobless benefits fell more than expected by -11.3k from -41.4K.
On the other hand, the workforce suffered a fall in real wages for the first time in more than two years in January as inflation is rising faster than wage growth. In the three months to January, wage growth slowed from 2.6% to 2.3%, the lowest level recorded since 2014.

On the monetary policy front, the Bank of England kept its interest rate at a record low of 0.25% by an 8-1 vote and made no changes to its asset purchases as the committee debates on how to tackle rising inflation. Furthermore, the central bank upgraded its growth projection for Q1 2017 from 0.5% to 0.6%. However, the MPC expects a slowdown in aggregate demand in 2017 as household demand declines in response to lower real income growth due to higher inflation.
In recent weeks, a sign of consumer spending slowdown compounded by this week's data shows a further squeeze on real income and a slowdown of the economy during the uncertainty England is facing during Brexit.

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Asia

Chinese Data Sending Mixed Signals
China's industrial production grew more than anticipated at 6.3% in February compared to last year's 6% boosted by stronger data from imports, credit, coal production, construction equipment, property sales and from last year's fiscal and monetary stimulus policies. Investment in infrastructure also surged more than expected to 8.9% in February 2017 from last year's 8.1%. Moreover, investment in the private sector increased to a one year high of 6.7%, which constitutes 60% of the total investment.
A weaker report showed on the other hand retail sales falling dramatically over the year to 9.5% in January and February, the lowest figures recorded since May 2003 due to the increase in taxes on small engine cars.
In conclusion, the Chinese economy continues to experience a solid start of 2017 supported by strong bank lending, high government infrastructure spending and a revival in private investment.
China's economy however continue to face challenging times ahead with high corporate leverage, debt to GDP ratio at 277% and most importantly fears of protectionism under US President Donald Trump.

BoJ Remains in Negative Territory
Bank of Japan monetary policy remained in an expansionary mode with the board voting 7-2 to keep its target purchases for the 10-year Japanese government bond to keep yields at around the zero bound. The BoJ also kept the short term interest rate at minus 0.1% and will continue to buy Japanese government bonds at an annual pace of around 80 trillion yen.
During their press conference, Prime Minister Abe stated "I don't see the need to raise our yield target just because a central bank of another country raises rates … Currency rates move on various factors, not just on interest rate differentials."
In conclusion, the Japanese economy is gaining positive momentum supported by a weaker Yen. However, economic growth and stable inflation still remain far from the levels promised by Prime Minister Shinzo Abe and the Bank of Japan.

New Zealand GDP Misses Estimates
New Zealand GDP expanded by 0.4% in the final three months of 2016 against estimates of 0.7% and down from 0.8% in Q3 2016. The figures were the weakest quarterly expansion since June quarter of 2015.
Growth was undermined by weak manufacturing and agricultural sectors with exports declining by 6.0%, the largest quarterly fall since 1992. The weakness was partly offset by an increase of 2.1% in services exports, leaving overall exports of goods and services down by 3.8%. Annual GDP growth for 2016 came in at 3.1%.

Kuwait

Kuwaiti Dinar at 0.30470
The USDKWD opened at 0.30470 on Sunday morning

Rates – 19 March, 2017

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.0671	1.0597	1.0782	1.0741	1.0660	1.0830	1.0788
GBP	1.2161	1.2106	1.2404	1.2394	1.2320	1.2490	1.2435
JPY	114.80	112.53	115.19	112.70	111.35	113.15	112.24
CHF	1.0107	0.9938	1.0116	0.9985	0.9900	1.0030	0.9933