Optimism Surrounding US Tax Reforms Pushes the US Dollar Higher

United States

Yellen Preserves the Optimistic Tone

The Fed's Chairwoman Janet Yellen portrayed an optimistic outlook on the US economy and for price growth in the months to come, suggesting the footprint of the recent hurricanes will likely moderate economic growth temporarily and should be followed by a rebound by year end. She restated that the persistence of undesirably low inflation this year has been a surprise. Although, she expects inflation to begin its northern momentum as the effects of temporary factors such as falling prices for consumer cellphone services begin to fade. As for market expectations, markets are skeptical on Yellen's outlook for future interest rates as FED members are not on the same page. The Fed fund futures show only a 70% chance of one rate hike in 2018, while the FED's dot plot indicate 3 rate hikes.

Reports from all twelve FED districts noted that the pace of growth expanded between modest to moderate across the US in September and October despite the inflow of hurricanes that caused major disruptions in some areas and sectors. Still, the economy seemed to have weathered down the storms better than anticipated. As always, one major theme continues to disappoint, "wage growth". Several districts reported difficulty in finding qualified workers across many sectors. Even the tightest labor market in years did little to heat up inflation. The Fed described the increase in wages and the cost of materials as modest. The main theme is that the Central Bank is on the road to hike a third time this year in December and the recent hurricanes were just a slight depressor for an economy now in its ninth year of growth making it one of the longest expansions ever.

Trumpflation may reemerge after the Senate accepted a budget plan that would allow them to advance with the tax remodel without the backing of Democrats. Despite having control of the government, Republicans have been unable to create a legislative achievement, setting further pressure on officials to succeed in passing a tax bill.

As for Europe, politics continues to dictate market trajectory as the standoff between Spain's central government and Catalonia escalates. The Spanish government has enough backing to disband Catalonia's parliament and hold new elections in January to try to resolve the regional government's push for independence.

On the currency front, the dollar index began the week on a strong footing after slightly hawkish remarks from the FED's Chairwoman, positive data on the US economy and a report that indicated President Donald Trump favored a hawk to head the Federal Reserve. On Wednesday, the dollar index lost ground after the housing report came in frail. However, the downward momentum was short lived due to renewed hopes for a major tax reform after the Senate approved a budget blueprint for 2018. The index began the week at 93.156 and closed on Friday at 93.701.

The euro extended its losses on Monday as the unclear political environment around the EU continues to diminish sentiment. The EUR/USD recovered all its losses it incurred at the start of the week and entered into positive territory on Wednesday as politics faded from the headlines, while taking advantage from the dollar's pull back. The EUR/USD closed its weekly session at 1.1783 down by 0.20% for the week.

The Sterling pound was under pressure the entire week on both fronts, politically and economically. After the release of the inflation and labor report, the GBP/USD persisted downhill. The GBP/USD lost 0.69% of its value last week.

Safe haven currencies like the Japanese Yen and Swiss Franc remained the weakest currencies for the week on resilient global risk appetite and a stronger US dollar. The yen and Swiss Franc lost 1.41% and 0.90% respectively versus the greenback this week.

In the commodities complex, oil prices surged on Monday through Wednesday as reports of clashes between Iraqi troops and Kurdish armed forces near Kirkuk sent WTI and Brent higher. Meanwhile, government data showed a larger-than-expected drop in US crude inventories. Brent crude was last trading near the $57 level.

Manufacturing Conditions Remain Optimistic

The New York Fed reported that the general manufacturing conditions in the state of New York soared to a three-year high of 30.2 in October, up by 5.8 points from the preceding month and topped market expectations for a reading of 20. The index was enhanced despite some of the key components actually worsened, like new orders, which fell to 18 from 24.9 and the average work week index came in at zero. On the positive front, the shipments index rose 11 points to 27.5 the highest level since October 2009 and the employment index showed the sturdiest reading since March 2015, while the change in hours worked remained constant.

Looking at the six-month outlook, firms remained optimistic about future conditions with the index for future business conditions rising by six points to 44.8 and the employment is expected to increase modestly. The dollar’s recent depreciations is part of the story, but domestic demand played a roll too. The overall message from this and other surveys is that the industrial sector remains resilient.

Moving on to the Philadelphia region, the manufacturing state improved to a five months high for the current month. The Philly FED claimed the index was elevated by 4.1 points to 27.9. The sub-component that trails the number of employees soared to an all-time high of 30.6 from 6.6 seen last month and expectations for hiring over the next six months bursted to the highest level in 33 years. Growth in the industry isn’t just stable, it’s accelerating, and businesses surveyed by the local bank remained bright on the future outlook.

Import Price Index Supports a Rate Hike

The price for foreign goods shipped to the US peaked to the highest level in 15 months, suggesting inflation could pick up in the near term following months of sluggish readings. The rise is attributed to rising petroleum and food costs for the month of September. Last month, prices for imported petroleum increased 4.5% after rising 5.0% in August. Food prices surged 1.8%, the largest gain since July 2016. The cost of imported goods rose 0.7% m/m, while core prices gained 0.3% m/m. Over the past 12 months the import price index has risen 2.7%. The data should further reinforce the FED’s case for one last rate hike before the year ends. Inflation has been one of the most closely watched measures this year since price growth has broadly remained cool despite strength in the labor market.

Hurricanes Take a Toll on the Housing Market

Recent Hurricanes in the US subdued the housing market, especially in the southern states last month, while a decline in building permits raised fears that the housing market recovery is stalling. The Commerce Department said housing starts dove 4.7% m/m, the lowest since September 2016 and building permits fell 4.5% m/m. The problem is that even before the storms struck, residential construction had almost deteriorated this year due to lack of land and skilled laborers as well as rising costs for building materials. The latest figures from the housing market may introduce a downward pressure on the third quarter of this year.

Europe & UK

Latest Inflationary Figures Support a Dovish QE Reduction by the ECB

The final euro area inflation figures for September did not offer any surprise as the consumer price index remained unchanged at 1.5% annually. Since last year inflation has roared in Europe, in September 2016 the annual rate was at 0.4%. However, the latest readings on price growth indicate inflation is stabilizing around the current levels. Core inflation deflated back to 1.1% from the 1.2% seen in August.

The factors that assisted higher prices on an annual term were fuels for transport (+0.20 percentage points), restaurants & cafes (+0.15 pp) and tobacco (+0.10 pp). The highest annual rates were recorded in Lithuania (4.6%), Estonia (3.9%) and Latvia (3.0%). In comparison to August, annual price pressures rose in eleven member states, remained stable in seven and fell in nine.

This is the last inflation reading before the ECB meets in October, and Draghi stated earlier that the bulk of the announcement regarding the future of QE should be delivered at the October meeting. In spite of the upward pressures from the oil prices, the ECB is still far from meeting its inflation target. The reduction in core prices should serve as a reminder that underlying inflationary pressures are still soft, one of Draghi's main concerns. With wage growth remaining tamed, the ECB will be particularly worried about low inflation. Hence the ECB will taper its asset purchases very gradually and there will be no announcement of when net purchases will come to an end to retain flexibility to be able to do more if needed and prevent further upward pressures on the euro.

Real Wages Continue to Diminish

UK’s consumer price index soared to the highest level in half a decade, far exceeding wage growth. Headline inflation advanced 3% on a yearly basis in September, while core CPI was unchanged at 2.7%. Inflation has risen from 1% to 3% over the past year, largely due to the fall in the value of the pound, which has lifted commodity, food and transport prices. The currency’s depreciation has influenced the heated inflation, but increasing global commodity prices were also a factor.

Consumer expenditure remains remarkably strong in the face of inflationary forces and frail wage growth, but the current squeeze on household funds is a slow burner on the economy and may take time to show its full effect. The above target inflation rate is intensifying pressure on the BoE to tighten its monetary policy before year end and market expectations for a hike at the November meeting currently stand at 66%.

Looking at the labor market, narrowing real wages persisted for the sixth month in a row despite the unemployment rate maintaining at a 42 year low of 4.3% as employment rose by 94K to 32.1 million. Real earnings may get squeezed further over the next few months as the single month reading for June (2.8% y/y, the strongest in 2017) drops out of the headline 3m-y/y rate. Average hourly earnings were unchanged at 2.2%.

The labor market report remains in line with a November hike, yet the high demand for labor failed to translate into significantly increased pay, indicating the UK’s labor market is great at creating jobs, but has difficulty in raising salary.

Retail Sector under Pressure

British consumers continue to experience hard times recently, with pressure on all fronts reducing the amount of disposable income available for buyers. The downward momentum in retail sales came as no surprise given the latest inflation readings. The persistent erosion in retail sales is a product of an economic squeeze on UK consumers at a time when confidence remains depleted and certainty is clouded by Brexit negotiations. In detail, retail sales were down by 0.8% for September and on a quarterly basis sales were

1.5% higher in the third quarter of 2017 compared to 2016. This is the slowest rate of annual increase since 2013, when sales finally started rising as consumers shook off the effects of the great financial crisis.

Nevertheless, the underlying picture of the retail industry remains one of growth, with sales increasing by 0.6% in the third quarter. That means sales will contribute to GDP growth in Q3. The large drop in retail sales may have a little impact on the BOE's immediate policy choice. The central bank remains on course to raise interest rates at its next meeting on November the second.

Asia

Mixed Chinese Inflation Data

China's yearly consumer inflation rate remained under 2% for eight consecutive months in September, the CPI advanced 1.6%, down from 1.8% recorded in August. The slightly weaker inflation is attributed to a decline of 1.4% in food prices from a year ago, which accounts for a significant part of the index's calculation. In contrast, Chinese factory prices surged more than expected to six months high, coming at 6.9% from an earlier figure of 6.3%. The inflated PPI is accredited to a thriving construction sector, which illustrates no sign of waning, a government crackdown on air pollution triggered fears of winter shortages and frenzied jumps in commodity prices caused by improving domestic demand.

The CPI is known as a lagging indicator, while the PPI is a forward looking indicator and with the latest figure coming in hot, may translate to a stronger CPI as producers pass the higher expenses to their customers. Overall, recent data also added to signs of a solid economy which may defy market expectations of a loss of momentum. The World Bank predicts the economy will likely expand 7% year on year during the remainder of 2017 thanks to a booming household consumption.

Growth Persists Despite Government Crackdown

Solid consumer spending and factory output fueled China's economy in the third quarter of 2017, despite the government's determination to curb the property market, the high degree of financial leverage and strengthened the enforcement of environmental regulations. The GDP cooled slightly to 6.8% in Q3 from 6.9% recorded in the previous quarter but still exceeded the government's full-year target of 6.5%. A modest loss of drive had been projected as the Chinese government took a new direction towards regulation and reform.

As for figures providing insight on the health of the economy, retail sales on a yearly basis rose 10.3% last month, which was welcome news for the economy especially as the economy transitions away from heavy growth in investments. Industrial output, which measures production at factories, mines and the utility sector, rose 6.6% from a year ago, the highest in three months. On the negative side, fixed-asset investments expanded at the weakest pace in 18 years, while property trades were subdued for the first time in over two years. The overall data indicated a stable growth picture rather than a slowdown. If the trend seen in the last few quarters persists, there is a chance that growth in 2017 will be higher than the previous year and that has not occurred since 2009. However, less supportive fiscal policy stance and slower credit growth may result in a slowdown over the coming months.

Treasury Group
Weekly Money Market Report
22 October 2017

Kuwait

Kuwaiti Dinar at 0.30220
The USDKWD opened at 0.30220 on Sunday morning.

Rates – 22 October, 2017

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.1806	1.1729	1.1858	1.1783	1.1580	1.1880	1.1840
GBP	1.3279	1.3085	1.3311	1.3188	1.2975	1.3290	1.3230
JPY	111.92	111.64	113.56	113.50	111.45	115.50	112.98
CHF	0.9753	0.9727	0.9852	0.9841	0.9675	1.0015	0.9814