Treasury Group

Weekly Money Market Report

07 May, 2017

"En Marche" for a Third Rate Hike

United States

Upbeat FOMC

While the political soap opera continues in Washington with the House of Representatives passing the healthcare reform bill aimed at repealing and replacing the Affordable Care Act; the Senate approved a $1.1 trillion spending bill that will fund the federal government through September and prevent a shutdown.

On the monetary policy front, the May FOMC meeting offered little clues this week as the Committee kept rates unchanged and was constructive on economic developments despite the recent softening in GDP growth and the drop in inflation. The committee did not give any signal on the next rate hike or changes in the Fed balance sheet policy.

On growth, the statement acknowledged, however dismissed the latest soft data noting that consumer spending remain solid, and that the Q1 slowdown was likely to be temporary. Sentiments were more upbeat on business investment. Neither the growth slowdown nor the decline in core inflation in March changed the Committee's expectations that growth will continue at a moderate pace, the labor market will strengthen somewhat further, and inflation will stabilize around 2% over the medium term.

On the data, the FOMC acknowledged that "the labor market has continued to strengthen even as growth in economic activity slowed. Job gains remain solid, on average, in recent months, and the unemployment rate declined. Household spending rose only modestly, but the fundamentals underpinning the continued growth of consumption remained solid". Inflation measured on a 12-month basis recently has been running close to the Committee's 2%.

Market probability of a hike stood at 90% for June in comparison to 67% prior to the FOMC meeting.

On the global economic front, the Eurozone growth may accelerate more and the ECB monetary policy guidance could change as the recovery picks up, ECB chief economist Peter Praet said, reinforcing expectations for a more upbeat economic assessment from the bank. Economic growth is broadening and there is potential for a positive surprise in the second quarter noting that inflation was also set to rise gradually to near the ECB's target by 2019.

On the foreign exchange side, the dollar index reached a 7-month low at 98.543 on Friday after an upbeat UK and Eurozone figures helped building pressure on the dollar.

The Euro continued to shun the French election risk and opened the week at 1.0905 and continued to surge reaching a six-month high of 1.1000 on Friday following the FOMC meeting and supported by the GDP figures coming on expectations. With the second round of the French Presidential Election on Sunday, the centrist candidate Emmanuel Macron is leading the polls and expected to easily win the election. The currency closed the week at 1.1000.

The Sterling Pound continued to be supported ignoring the risks emanating from the Brexit negotiations. Cable held its ground above 1.2900 and is expected to trade with high volatility should the political fight with the EU persist. The Sterling closed the week at 1.2984.

The Japanese Yen reached a six-week high at 113.04 against the dollar but softened back to close at the 112.72 level on Friday.

On the commodities side, oil prices continued their slide by the end of the week, falling 2.9% on fears of rising output. Crude oil closed around the $46, back to levels last seen before the OPEC deal, as the shale revival appears to be making the OPEC cuts ineffective. After dipping below $44 Friday, prices closed the week slightly higher than the low, meanwhile, shale drillers are pressing ahead with their longest expansion since 2011.

Mixed US Data

US manufacturing missed expectations in April as employers reported less hiring and a slower pace of incoming orders, according to the ISM report. Indeed the purchasing manager's index slipped to 54.8 from 57.2. Economists had forecasted a reading of 56.5, with the biggest decrease was recorded in the indices that track new orders and employment.
Non-manufacturing index on the other hand rose to 57.5, the second-highest since October 2015 from 55.2 in March. The results are in line with projections for a rebound in economic growth this quarter coming off the weakest pace in three years.
The surge in non-factory orders also extended to customers beyond US borders export demand climbed to the highest level in nearly a decade.

On the employment front, US non-farm payroll recovered in April after the disappointing March figures. April non-farm data came at 211K versus an expected 194K setting the stage for a potential interest rate hike in June. According to the report, job gains occurred in most sectors ranging from leisure and hospitality to finance and mining sectors. Furthermore, unemployment claims for the previous week came at 238K against an expected 246K. Finally the unemployment rate came at 4.4% as a result of the performance of both public and private sector.

Europe & UK

Eurozone Economic Growth at Six-year high

Euro area economic growth accelerated to a six year high at the start of the second quarter. This was signaled by the final Eurozone PMI Composite Output Index rising to 56.8 in April, up from 56.4 in March and the earlier flash estimate of 56.7. Activity has expanded for 46 months in a row. Output growth accelerated at manufacturers and service providers, with rates of increase hitting 72-month records in both cases. The slightly sharper expansion was again registered in manufacturing. Underpinning growth of economic activity was a strong increase in incoming new business. New orders rose for the twenty-ninth month running, with the rate of expansion staying close to March's high.

UK Upbeat Construction and Manufacturing Data

The UK construction PMI rose to 53.1 in April against expectation of 52 and up from 52.2 in March. According to the report, "April's survey reveals a positive start to the second quarter of 2017, with a robust upturn in civil engineering activity helping to boost the construction industry. There were also more encouraging signs from the house building sector, as growth recovered to its strongest so far this year. However, the performance of the commercial building sector remained subdued in the context of the past four years."

Britain's factories enjoyed their fastest growth for three years last month from 54.2 in March to 57.3 in April on the back of strong demand at home and abroad, according to a survey that will temper worries about a Brexit-driven economic slowdown this year. The manufacturing sector, which makes up about a tenth of the UK economy, enjoyed the strongest pick-up in new work since the start of 2014 and smashed expectations in April. Firms also took on new workers at a faster pace and ramped up production.

Asia

RBA Concerned about Household Debt

Reserve Bank of Australia Governor Lowe said that "the recent increase in household debt relative to our incomes has made the economy less resilient to future shocks. Double-digit growth in debt owed by investors at a time of weak income growth cannot be strengthening the resilience of our economy. Nor can a high concentration of interest-only loans." In such a case, "an otherwise manageable downturn could be turned into something more serious".

Another negative surprise came on the back of the disappointing trade surplus falling more than expected in March to AUD 3.1 billion, despite upward revisions across the prior four months, with February now the second highest on

record at AUD 3.7 billion. The trade data implies a large net export drag in the first quarter pressuring down economists' GDP forecast.
Finally, the RBA latest Statement showed a small upgrade to GDP, with growth by June 2018 now forecast between 2.75 and 3.75%. The Bank said that it had greater confidence that inflation would pick up, but that's in the context of an inflation forecast that doesn't return to the Bank's target range until June 2019. The cash rate is likely to be stuck at 1.5% for longer than the market has priced.

China Property Sales Declined

According to data from a the Chinese real estate services, property sales volumes in China's top 50 cities declined by 19% on a yearly basis and 10% on a monthly basis. This reflects the adverse impact of the recent round of tightening measures that have been rolled out since mid-March. The government has been trying to curb property prices in China this year.

Monetary Policy will lead to Higher Prices

Bank of Japan Governor Kuroda said that "the mindset is still quite cautious about inflation expectations, but I'm quite sure that with continuous accommodative monetary policy, supported by fiscal policy, we'd be able to eventually raise wages and prices significantly".
The projected growth rate of 1.5% is "not great" but it is well above the medium-term potential growth rate which means that the output gap will shrink and become positive while the labor market continues to tighten. In that event, wages and prices would eventually rise to achieve the 2% inflation target around the fiscal year 2018. He acknowledges that "headline inflation has been quite slow to adjust upward" in part because of weakness in oil prices.

Kuwait

Kuwaiti Dinar at 0.30415

The USDKWD opened at 0.30415 on Sunday morning.

Rates – 7th May, 2017

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.0988	1.0948	1.1000	1.0995	1.0890	1.1200	1.1048
GBP	1.2918	1.2898	1.2983	1.2979	1.2855	1.3155	1.3016
JPY	112.44	112.06	112.81	112.71	111.20	114.75	112.30
CHF	0.9861	0.9856	0.9902	0.9868	0.9690	0.9960	0.9815