Weekly Money Market Report
02 May 2019

Trade War Rattles Markets

>NBK Treasury
+965 22216603
tsd_list@nbk.com

Highlights

- China: “We are not afraid of a trade war.”
- Trump surprises Mexico with tariffs over immigration policy.
- US GDP revised lower to 3.1%.
- European elections offered little support to euro.
- Chinese manufacturing sector contracts in May.
- Oil prices fall 7% over trade war concerns.

United States

Trade War Rattles Markets

Financial markets were rattled last week as trade tensions across the globe continued to deteriorate. On a state visit to Japan, US President Trump claimed the US is not ready to make a trade deal with China ensuring the latest implementation of tariffs on June 1. Chinese vice Foreign Minister Zhang Hanhui called the US actions “economic terrorism and bullying” and that they are not afraid of a trade war. Beijing has said multiple times that they have many tools in their arsenal for retaliation. The latest being, considering restricting exports of rare earth minerals used in US industries and establishing a list of foreign entities that damage the interests of domestic companies. The blacklisted companies could potentially see the same ban placed on Huawei by Trump.

Although negotiations have seemingly failed with China, it did not stop Trump from shifting his campaign elsewhere. Mexico became the newest casualty of Trump’s trade war after he unexpectedly announced tariffs on all Mexican goods. This time, the tariffs were not about unfair trade practices or trade deficits, but to coerce Mexico into curbing the surge of illegal immigrants crossing the southern border. The tariffs will start at 5% on June 10 and increase monthly until reaching 25% on October 1, unless Mexico takes immediate action, Trump said. At the time of announcement, Mexican foreign minister Jesus Seade was delivering the US led, revamped North American trade agreement to replace NAFTA, for official ratification. "We're in a good moment building a good relationship and this comes like a cold shower," he commented.

Global stocks declined last week as the latest exchanges between Washington and its trade rivals signaled a heightened risk of a prolonged trade war, fueling investor concerns about the impact on global economic growth. The Dow Jones and S&P both fell -1.8%, while the Eurostoxx 50 and Japanese Nikkei 225 were lower by around 3%. Expectedly, there was a flight towards safe haven government bonds. European bond yields fell to record lows including the German 10 year treasury which actually dipped into negative territory earlier in the month. The US dollar also gained strength as bond investors looked for higher returns in the US. The US 10 year treasury yield fell to a two year low of 2.15% with the fresh influx of buyers. The yield curve is now inversed with the shorter date bonds of 1 to 12 months now yielding higher than the 10 year.

The overwhelming concern in the markets suggests that market participants believe that current Fed policy is too tight in light of the deteriorating growth outlook, and inflation undershoot. Indeed, Fed Vice Chair Clarida provided the strongest signal yet that the Fed is open to rate cuts if the outlook dims. He stated “let me be very clear that we are attuned to potential risks to the outlook and if we saw a downside risk to the outlook then that would be a factor that could call for a more accommodative policy." The latest GDP figure, while high, was revised lower to 3.1% from 3.2% and with further confrontations with the US's largest trading partners, the loss of growth could become more apparent. Reuter's polls now expect a 70% chance of an interest rate cut by September and a 90% chance by December.

Europe

EU Elections

The outcome from the EU elections added little support for the euro despite increase in support for populist and anti-EU parties was less than feared, and partly offset by a rise in support for the liberals and greens. A pro-EU majority will help to limit populist influence and ability disrupt in the new EU parliament. However, concerns arose after Italy's right-wing party The Northern League saw an increase in wins. The party could potentially lead the Italian government to another budget face-off with the EU which could prove destabilizing for Italy's economy and financial markets. The European Commission is already considering disciplinary steps against Italy on June 5 over the country's rising debt and deficit levels, which break EU rules. Under the rules called the "Stability and Growth Pact" Italy must reduce its structural deficit by 0.6% of output until it reaches balance or surplus. The compromise struck late last year, which the Commission called "borderline" and "not ideal," allowed Italy to keep its structural deficit and debt unchanged.

The elections also weighed down the euro with the performance of the ruling Conservative party in the UK which won only 9% of the vote compared to 23% in the previous EU election from 2014. The loss highlights an increased risk of a more disruptive "No Deal" Brexit outcome. It will increase pressure on the new Conservative leader to pursue a tougher negotiating stance with the EU. The increased likelihood of a "No Deal" Brexit poses the main downside risk for the pound, but could also result in a weaker euro as well.

Asia

China Manufacturing

China's factory activity shrank more than expected in May adding pressure on Beijing to roll out more stimuli to support an economy in the middle of a bruising trade war with the United States. China's exports unexpectedly fell in April on a sharp drop in shipments to the United States, while industrial output and retail sales also showed surprisingly weak growth last month. Furthermore, earnings at China's key manufacturing sector have been declining since November last year, with the exception of March, as both domestic and global demand slackened. The official Purchasing Managers' Index fell to 49.4 in May from 50.1 in April. Readings below the 50-point mark indicate contraction on a monthly basis.

Commodities & Currencies

Oil Prices Fall over Trade Concerns

The trade worries also weighed on oil as expectations of lower demand from less global trade dropped prices 7% over the week. The trade concerns were so profound that prices dropped despite lower supplies in the market due to Iranian sanctions. OPEC and its allies are still planned to raise production to compensate Iran's exit. Brent crude opened the week at $68.40 and closed at $64.49.

Safe Haven Demand

In the currency markets, safe havens were the clear gainers. The Japanese yen was in clear demand throughout the week though the major gains came Thursday after Trump's tariff announcement. The JPY/USD appreciated 1% to 108.26. The Swiss franc was a bit more volatile due to its heavy exposure to Europe and initially lost value. Again, the story was the same with a rebound after Trump's comments. The USD/CHF closed near its open at 1.0008. Finally the USD, this year's safe haven of choice, also gained momentum beating out the euro and British pound almost hitting this year's high before rebounding lower on trade concerns. The US dollar index was 0.21% stronger at 97.758.

Kuwait

Kuwaiti Dinar at 0.30380

The USDKWD opened at 0.30380 Sunday morning.

Rates –02 June, 2019

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	High	Low	Close	Minimum	Maximum	Forward
EUR	1.1194	1.1215	1.1114	1.1167	1.1075	1.1375	1.1255
GBP	1.2726	1.2755	1.2557	1.2631	1.2555	1.2845	1.2699
JPY	109.30	109.92	108.26	108.26	106.35	109.30	107.50
CHF	1.0009	1.0098	0.9998	1.0008	0.9810	1.0105	0.9924