Weekly Money Market Report

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The Brexit Conundrum Might Be Coming to an End

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Highlights

- UK Conservatives take control of government with a landslide victory.
- Trade prospects turn optimistic.
- Global central banks on hold, inflation in a muted state.
- Safe haven currencies trading in the red terrain.
- GBP best performer in FX sphere.
- US yield curve steepens.

United States

Major Geopolitical Risks Recede

The two major risks to the global economy have diminished substantially last week as the Conservative party won the UK's general election with a landslide and reports reached markets that President Trump had agreed to a limited "Phase One" trade deal with China. As the year comes to an end, the geopolitical atmosphere seems to be cooling down. In spite of the current optimism seen in financial markets, the trade prospects could easily disappoint again, which has occurred several times over the course of the year. If both nations formally agree and sign the phase one deal, it could limit the deterioration of the bilateral relationship. However, the disputes facing the two largest economies are complex and include many different aspects. Therefore, they are unlikely to all be resolved quickly. Officials acquainted with the negotiations said that American negotiators were proposing to rollback existing tariffs on Chinese goods by around 50% and postpone the upcoming tariffs scheduled on December 15 if China promises to purchase US farm products worth $50 billion in 2020.

Looking at the worst performers in the FX market, the Japanese yen took the lead followed by the US dollar. Safe haven currencies were continuously trading the red zone, while currencies of export oriented economies thrived. The USD/JPY is heading towards a 7-month high, while the dollar index fell to a 6-month low of 96.588. On a weekly basis, the dollar index has shed 0.53% of its value versus a basket of currencies. The yen is down by nearly 0.70% against the USD in the past five trading days.

In the US bond market, the yield on the 10-year note rose to a four-week high of 1.903% after the positive developments on trade, from 1.79% seen on late Wednesday. It was evident from the rise in yields that bonds were in selling mode. As trade worries eased, the yield curve steepened for the first time in four days, with the spread between the two-year and 10-year note yields expanding to as much as 23.10 basis points, the widest gap in four weeks.

The FED Cements its Neutral Stance

The outcome of last week's FOMC meeting offered no surprises as the overnight rate remained unaltered at 1.50-1.75% with a unanimous support from the committee. The majority of members on the FOMC expect policy to finish 2020 at the same level seen in 2019, while the market is pricing in one cut by late 2020. Thirteen members expect rates to stay on hold next year, while four see a hike. In September, there were seven FED officials recommending a rate above 2% for 2020. Now there are none.

The FED Chairman portrayed a resilient picture on the US economy by stating that "our economic outlook remains a favorable one despite global developments and ongoing risks." "As long as incoming information about the economy remains broadly consistent with this outlook, the current stance of monetary policy will likely remain appropriate."

Looking at projections, policy setters displayed more confidence in the US labor market by lowering their predictions for unemployment for the next three years. They dropped the long-run unemployment rate to 4.1% from 4.2%. GDP is seen at 2% next year and 1.9% in 2021, both unchanged from the last estimates. Inflation is expected to hit 2% in 2021, also unchanged from the prior projection. Overall, the monetary policy message is that the central bank is on hold for now and that it would take some significant change in the outlook to induce the FED to move in either direction.

Europe & UK

Conservatives Win General Election, Brexit to be Concluded
The Brexit turmoil which has created a cloud of uncertainty for years and almost pushed the UK economy into a recession is on the verge of conclusion. PM Boris Johnson's snap election gamble has paid off remarkably as the Conservative party secured a crushing victory. The Conservative party (Tories) won 365 seats in Parliament easily securing a majority and is considered as the largest win for the Tories since the late 80s. On the other hand, the Labor party attained 203 seats only, the worst result for the party since 1935. The election results indicate that British citizens are in favor of leaving the EU with Boris's agenda; the Tories' strong pledge to "Get Brexit Done" clearly echoed well with the public.

All of the elected Tory members are in favor of Johnson's Brexit deal, so it should be relatively smooth sailing for the government to pass its Brexit bill. The new Conservative government will be less reliant on hard Brexiteers which could make concessions and negotiations easier with the EU. The election results brings some short term clarity on Brexit, however the debate might rapidly shift from the risks of a 'no deal' Brexit to the risks of a 'no trade deal' one. Hence, the Brexit drama isn't out of the woods yet. Brexit may continue to pressure economic activity as the challenging task of forging the UK's new trading relationships is just beginning.

The Sterling pound was the top performer among G10 currencies last week, climbing to a 19-month high of 1.3514 after the polling results were released. In weekly terms, the GBP gained around 185 basis points against the greenback. Markets may witness a less volatile Sterling pound in the months ahead as the Brexit risk becomes a less vital driver of performance. Since the Brexit referendum, the pound's trajectory has been mainly dominated by political headlines. This political trend could come to an end with economic fundamentals back in play.

New ECB president Maintains Policy Settings
The European Central Bank maintained its loose monetary policy rate at a record low of -0.50% and stuck to its asset purchase program of 20 billion euros per month. The ECB restated its key message from the previous meetings, saying that rates will not rise "until it has seen the inflation outlook robustly converge to a level sufficiently close to the 2% objective." Moreover, the new ECB president Christine Lagarde mentioned that interest rates could move lower until the inflation objective is achieved. It looks like years of negative interest rates and more than €2.6 trillion of ECB bond purchases have failed to boost prices and growth. In conclusion, no new light was shed on the European economic outlook and monetary stance of the ECB. Consumer inflation is currently at 1% y/y, way below the ECB's objective and as such rates are likely to remain in a negative environment for the time being. Financial markets currently expect the ECB to maintain its monetary settings throughout next year, a view that was fortified by the FED signaling that it was unlikely to touch US interest rates in 2020.

Negative Interest Rate Environment to Reside
It was no surprise that the Swiss central bank voted to uphold its negative interest rate environment at -0.75%, especially with annual inflation at -0.3% in October and -0.1% in November. The Bank's tone remained extremely dovish and labeled the Swiss franc as 'highly valued'. The SNB reiterated the importance of negative rates and FX interventions to curb the appreciation of the currency if warranted. The SNB chairman said "It would make no sense to conduct an irresponsible monetary policy only to get

rid of the negative rates. As soon as the outlook will change, then we will change, but we have no good idea when that will happen because it really depends on the international environment."

On the expectations front, price growth forecasts were cut for the second successive quarter. Inflation is now seen by the SNB at only 0.1% in 2020 and 0.5% in 2021, instead of 0.2% and 0.6% projected in September. The Bank assumes a pick-up thereafter but inflation is not expected to exceed 1% until Q3 of 2022.

All in all, the SNB vowed to stay active in the FX market to ease upward momentum on the CHF, which has gained around 3% in value against the euro this year. Policymakers also indicated that further rates cuts were probable, but the consequences to act remain relatively high given the side effects of negative rates. For the Bank to lower rates further it would probably require a significant risk aversion event leading to a stronger franc. In such a scenario, the risk to the price stability mandate would probably make rate cuts more likely.

The single currency (EUR) has appreciated tremendously last week and rose to a 4-month high of 1.1199 versus the USD. Optimistic expectations on trade and Brexit combined with Germany's ZEW indicator of economic sentiment that turned positive in December, rising to the highest level in 21 months paved the way for the euro's rise. The week ended with euro gaining 0.57% over its dollar counterpart.

Kuwait

Kuwaiti Dinar at 0.30320

The USDKWD opened at 0.30320 Sunday morning.

Rates – 15 December, 2019

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	High	Low	Close	Minimum	Maximum	Forward
EUR	1.1056	1.1128	1.1051	1.1119	1.0950	1.1295	1.1192
GBP	1.3134	1.3514	1.3049	1.3325	1.3230	1.3570	1.3369
JPY	108.59	109.70	108.41	109.36	108.40	111.30	108.72
CHF	0.9901	0.9910	0.9804	0.9838	0.9735	0.9920	0.9770