Treasury Group

Weekly Money Market Report

23 April 2017

It is all about the French

United States

Le Pen, Macron, Fillon, Melenchon

Finishing the week in a low volatility environment and well supported despite the uncertainty resulting from the French election, the latest price actions on the Euro currency seems to point to a potential muted election result. The profit taking that happened in the precious metal markets also seems to point that markets are underestimating the downside risks in the immediate aftermath of the first round mainly due to the difficulty of understanding and pricing the repercussion of a Le Pen or Melenchon win for the European Project.
The general narrative goes that even if Le Pen makes it through to the second round, the polls show that she loses in every scenario. According to the latest surveys, if Le Pen makes it to the second round, she would lose 65% to 35% against Macron.

As we mentioned many times in earlier communications, the ECB remains in a wait and see mode for the election results to unfold. If the elections do not yield an Anti-European outcome, it is likely that the Euro would rally supported by ECB tightening later this year. If Le Pen wins the first round by a relatively solid margin compared to her running mate, then a volatile environment is likely to result in the next two weeks prior to the second round.

In other major events this week, US Treasury Secretary Mnuchin was upbeat over the new potential tax reforms. Mnuchin said that “we’re pretty close to being able to bring forward what is going to be major tax reform” regardless of whether or not health care reform gets done. Mnuchin also said that he hoped passing such tax overhaul will not take “till the end of the year”. Given the plan’s key position within Donald Trump’s campaign rhetoric and the previously failed health reform, delivering the tax overhaul will be key in affirming that the President does have what it takes to deliver on campaign promises and his fiscal agenda. Tied to this, market indications for a June rate hike rose and now stand at 60.5% after Robert Kaplan, Dallas Fed President, reiterated that he felt three increases this year was still desirable.

For now, US yields continue to slide since the peak achieved in the beginning of 2017 and stand now at around the 2.24% on the ten years. The low March inflation print has however given the FOMC an inflation problem. Indeed, despite the hawkish rhetoric from Dallas Fed, the drop makes it very likely that the FOMC's next inflation forecast change is a downgrade resulting into a drop of the next Fed dot plot release. In summary, investors continue to shun the dollar on expectations of a more dovish Fed and shift to higher-yielding currencies despite global political risks on the rise.

On the foreign exchange side, the US Dollar also seems to be waiting as well for the election result to point in either direction. After starting the week under pressure following President Trump comments over the dollar strength, investors continue to dump the dollar on the back of faltering economic data.

Unsurprisingly the news of the snap election in the UK was initially most felt in foreign exchange with Sterling Pound rallying immediately and closing 3 big figures higher or +2.20% at $1.284, the highest level since October 3rd. That was the biggest rally for the Pound versus the Dollar since January 17th when PM May delivered what was largely considered a fairly balanced Brexit speech. The currency closed the week around the 1.2814 level.

On the back of falling US interest rates, and Japan reporting trade surplus, the Yen reached extreme levels this week at 108.13 against the US dollar. Given the weakness in the US data as of late, and the move in US treasuries, the Japanese Yen continue to well bid going into the French election. The Currency closed the week at the 109.10 level after Kuroda said the BoJ will continue its very accommodative monetary policy and maintain the current pace of QE for some time.

In commodity markets, Oil traded steady this week following a more than 3.5% fall in both benchmarks earlier this week as doubts emerged over the effect of an effort led by the OPEC to cut production by almost 1.8 million barrels per day during the first half of the year.

According to newspapers, a number of major crude-producing countries reached an initial agreement to extend output cuts as persistently high stockpiles weigh on prices. OPEC and other major suppliers have failed, after three months of limiting production, to achieve their target of reducing oil inventories below the five-year historical average.

Fed's Fischer Downplays Normalization Risks while Kaplan Argues for Rates Hike

Vice Chairman Fischer downplayed this week the risks of monetary policy normalization in the US for the global economy. In his opinion, current account deficits and inflation expectations are in better shape compared to the 'taper tantrum' episode across emerging markets and commodities. Chinese growth has also been stronger compared to last year.
Fischer also commented that the US monetary policy normalization would likely be measured. "A gradual and ongoing removal of accommodation seems likely both to maximize the prospects of a continued expansion in the U.S. economy and to mitigate the risk of undesirable spill overs abroad"

Dallas Fed President Kaplan reiterated that he thinks the median of three rate hikes this year remains an appropriate baseline but that the U.S. central bank has the flexibility to wait and see how the economy unfolds. New applications for U.S. jobless benefits rose slightly more than expected last week, but a drop in the number of Americans on unemployment rolls to a 17-year low suggested the labor market continues to tighten.

Beige Book, Split between Modest and Moderate

In its latest Beige Book, the Fed mentioned that the "economic activity increased in each of the twelve Federal Reserve Districts between mid-February and the end of March, with the pace of expansion equally split between modest and moderate. In addition, the pickup was evident to varying degrees across economic sectors." The Fed also noted that "manufacturing continued to expand at a modest to moderate pace, although growth in freight shipments slowed slightly.
Consumer spending varied as reports of stronger light vehicle sales were accompanied by somewhat softer readings in non-auto retail spending

On a different front, the Philadelphia Fed's survey results suggested that regional manufacturing activity continued to expand in April, but a slower than expected pace.
The Philly Fed said its index for current manufacturing activity in the region fell to 22.0 in April from 32.8 in March, although a positive reading indicates continued growth. Market expectations were for the index to drop 25.5.
The bigger than expected decrease by the index was partly due to a significant slowdown in the pace of new orders growth, as the new orders index tumbled to 27.4 in April from 38.6 in March.

The IMF Turning More Optimistic

The IMF raised global growth projections by 3.5% this year and 3.6% for 2017. The higher growth forecast is attributed to increasing oil prices, which boosted inflation readings and supports economies that dependent on commodity exports. The IMF expects the U.S. to grow by 2.3% in 2017, up from 1.6% last year on expectations of fiscal stimulus. For China, growth is expected to come at 6.6% in 2017 and 6.2% in 2018. On the other hand, the institution warned on low productivity growth and high income inequality in advanced countries. However, the real issues the IMF stated are escalating political tensions, trade disagreements and the rise of populism around the globe

Europe & UK

It is all about the French Election

Less than two weeks to the first round of the French elections, the dovish ECB rhetoric and increased anxiety around the election are the two main drivers of European price action this week.
Although a market friendly outcome for the election could result in the currency moving back higher, the medium term will depend largely on the ECB.
For now, the elections polls will be the key driver of the actions over the short term. Macron and Le Pen remain neck and neck at about 24 each for the first round, and the most recent poll showed a win of Macron in the second round. However with polls this close, markets are likely to remain on the edge for the next three weeks.

Beginning of the Divorce

According to newspapers, Brussels has begun to shut out British groups from European contracts and will urge companies in the UK to move to the EU. When awarding direct contracts for research projects or services, the commission and its agencies will be expected to take account of the fact that Britain may be a "third country" within two years. According to the report, “apart from the legal requirement for a contracting party to be established in the EU, there may be political or practical reasons that speak in favor of contracting parties established in a specific member state, not only at the conclusion of the contract, but also throughout the duration of the contract.”

Snap election On June 8

After months of public assurances that a Snap elections would not be on the agenda, UK Prime Minister May on Tuesday announced her intention to seek an early general election on June 8. After debating, the Parliament gave her the go-ahead. The justification according to the narrative was the opportunity for extra ‘room to maneuver’ after 2019. Or as May put it, a fresh mandate to take to Brexit negotiations. So in summary, the general election will take place on June 8. Markets took the news with a positive twist allowing the currency to strengthen. The problem remains with a deteriorating economy and uncertainty representing further risks for GBP; it seems as if the market got ahead of itself in unwinding all the negativity around the currency.

Asia

RBA Worried about the Labor and Housing Market

Data released this week showed a larger than expected jump in the number of jobs added in Australia during March. The RBA April meeting minutes however revealed a different picture with the Bank expressing its worries about the labor and the housing market. In the minutes, the Bank mentioned that the Labor market had “softened” and evoked more concern that previous months. “Although forward-looking indicators of labor demand continued to suggest an increase in employment growth over the period ahead, this had been true for some time without leading to an improvement in labor market conditions”
Concerning the housing market, the RBA said that “growth in housing credit continued to outpace growth in household incomes, suggesting that the risks associated with the housing market and household balance sheets had been rising”, but that it would take some time to assess the impact of recently-introduced measures aimed at taking some of the heat out of the market

Japan's Healthy Manufacturing

Japan's manufacturing PMI rose to 52.8 in April from 52.4 in March. The data released this week showed the activity in Japan expanded at a fastest rate in 2 months largely due to a jump in the new export orders. Indeed, the index for new export orders rose to 53.9 from a final 51.9 in the previous month. The output component of the PMI index was up at 53.6,up from 53.0 in March.

In a televised interview this week, BoJ Governor Kuroda said that the BoJ will continue with its very accommodative monetary policy and maintain the current pace of QE for some time. While acknowledging improved growth prospects, he called the inflation rate still quite slow, and cited risks to BoJ's 2% inflation goal if the yen appreciates. Regarding the inflation goal, he admitted there was still "a long way to go."

Chinese Growth: No Hard landing

China GDP data came in better than expected, with aggregate growth at 6.9% on a yearly basis in the first quarter of 2017. This compared to expectations of 6.8%, and a yearly growth rate of 6.7% last quarter. The strong performance of retail sales is likely support proponents of China's ongoing rebalancing.

Even with the tightening in money markets, the overall credit supply into the economy is clearly sufficient to continue to drive growth. This is expected to remain the case through to the key political transition in early November. The threat to this is that rising inflation, as implied in a nearly 5% GDP deflator in this release, means that more tightening has to come through sooner than the market expects.

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Kuwait

Kuwaiti Dinar at 0.30445

The USDKWD opened at 0.30445 on Sunday morning.

Rates – 23 April, 2017

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.0612	1.0660	1.0777	1.0726	1.0554	1.0920	1.0779
GBP	1.2528	1.2513	1.2904	1.2814	1.2690	1.3020	1.2845
JPY	108.66	108.11	109.48	109.10	106.90	110.75	108.69
CHF	1.0035	0.9938	1.0057	0.9958	0.9880	1.1100	0.9903