Weekly Money Market Report

24 March 2019

US Fed: No Hikes in 2019

United States

US Dollar Rebounds Despite Fed’s Dovish Tone

The economic calendar last week was filled with central bank meetings on both sides of the Atlantic, however all eyes were focused on the US Federal Reserve. The dovishness from US monetary policy officials should have been widely negative for the greenback but instead of extending Wednesday’s loss of around 0.70%, the dollar rebounded. Better than expected manufacturing data out of the Philadelphia region, lower US jobless claims and the lingering Brexit puzzle paved the way for a slightly stronger dollar. The dollar index opened the week at 96.481 and ended Friday’s session at 96.495.

US Federal Reserve officials waved the white flag on tightening monetary policy last week as central bank officials indicated that rates would remain constant in 2019. The Fed’s plans for further rate increases have pivoted intensely since late last year. It was only back at the September FOMC meeting, that the Fed planned to deliver a further three hikes this year on top of the four hikes in 2018. The Bank’s effort to normalize monetary policy by rising interest rates has come to an end. The Fed maintained its overnight rate at 2.25%-2.50% with a unanimous vote.

Then there’s the Fed’s balance sheet, which has grown from around $800 billion before the Great Financial Crises to a high of $4.5 trillion. The Fed has been gradually lowering the money supply in the economy since 2015. However, after last week’s FOMC meeting, the Fed also delivered a dovish policy update on their balance sheet plans. The Fed will now halt its balance sheet shrinkage by the end of September and is expected to reach about $3.5 trillion by then. The Fed Chairman stated "'Patient' means that we see no need to rush to judgment." "The data are not currently sending a signal that we need to move in one direction or another, in my view," he said.

As for growth prospects, the Fed has confirmed that the US economy has lately lost some upward momentum and lowered their 2019 growth forecast by 0.2% to 2.1%. The Bank also expects 2020 growth to fall below the 2% mark. Financial markets confirmed the dovish interpretation as the US 10 treasury yield tumbled to a 14-month low of 2.416%. Back in October the 10-year yield reached a high of 3.26%. The 10-year yield was also pressured by weakening economic data out of the US and Europe. This caused the short term interest rate (3-month treasury yield) to rise above the (10-year yield). The above inversion has previously taken place in 2007, before the Great Financial Crises. Hence, market signals may be indicating that a recession is on the way. In conclusion, the Fed seems to have ended its three-year strategy to tighten monetary policy while moderate inflationary pressures leave the central bank sufficient room to proceed with caution.

Equities

European Equities Slide into Negative Territory

European stock markets fell back on Friday after downbeat manufacturing data from Germany reignited fears of a recession in the region's biggest economy, erasing early gains on relief at the extension of Britain's Brexit deadline. The flash PMI survey showed German manufacturing contracted further in March, registering its lowest reading since June 2013. The euro zone-wide flash manufacturing PMI also showed businesses performed much worse than expected this month. The European STOXX 600 index slipped for a third day in a row falling over 1% on Friday after the release of the surveys. The French CAC 40 index followed suit falling over 2%.

Commodities

In the commodities complex, oil prices are set for a third straight week of gains due to supply cuts by OPEC and US sanctions on Iran and Venezuela. However, prices dipped after reaching new 2019 highs on Friday. As economic growth has slowed across Asia, Europe and North America and no breakthrough emerging in the trade stand-off between Washington and Beijing could potentially dent fuel consumption. Benchmark Brent crude closed out the week at $67.03.

Europe & UK

In the currencies market, the euro began the weekly session on a strong footing and soared around 0.80% on Wednesday after the dovish comments from the US Federal reserve. The EUR/USD rose to an 18-day high of 1.1448. However, the positive momentum was short-lived, pressured by frail euro-zone PMI indicators. Looking at PMI indicators, the French services PMI, French manufacturing PMI, German manufacturing PMI and euro-zone manufacturing PMI all came in below the 50 points mark. This suggests that the aforementioned sectors are contracting. The EUR/USD opened the week at 1.1318 and closed on Friday at 1.1313.

The Brexit Saga Lingers on with more Uncertainty

European leaders have offered PM May an additional 2-week extension from the March 29 deadline until April 12. The small extension gives the UK a tight window to secure MPs’ backing for a third vote in the British parliament or plan for another course of action. The April 12 date is important since it is the last day that the British government can issue an order under UK law to take part in EU parliamentary elections in May. EU representatives explained that Theresa May wanted to extend the deadline until June 30, however Britain's refusal to take part in EU elections meant that Britain must exit the block before May 22. Subsequently, in order for the UK to further extend the Brexit deadline, it must participate in EU election.

May’s Brexit deal has been rejected twice already in the House of Commons and the House Speaker John Bercow denied her appeal for a third vote in parliament. The Speaker of the House concluded that sufficient changes should be made to approve a third vote in parliament, while May’s deal with the EU hasn’t changed. Thus, a third vote on May’s deal seems somewhat improbable without the EU’s acceptance for amending the Irish backstop.

As the Brexit conundrum lingers on, the Sterling pound is trading in a volatile manner and that volatility is expected to persist until a clear path is drawn. The GBP depreciated by the biggest one-day fall this year of 1.3% after President Macron warned that unless the British parliament approved Mrs. May’s agreement with the EU, the UK was heading towards a no-deal exit. The GBP lost 0.62% of its value to the US dollar last week.

Resiliency in UK Labor Sector

The British labor market continues to defy Brexit uncertainties with robust employment figures. The economy added 222,000 jobs in the three months to January, the fastest pace of hiring in three years. The stellar job growth data aided the employment rate in breaking a new record high of 76.1%, while the unemployment rate declined to a 44-year low of 3.9%. Both total wages and wages excluding bonuses are at 3.4%, way above the 1.9% consumer inflation. Hence, accounting for the effects of inflation, wages are currently 1.5% higher than consumer inflation. The positive gap between wages and inflation provides British consumers with more purchasing powers that may support the dominant UK service sector. Despite the remarkable data, the Sterling pound barely edged up after the figures were released. It seems financial markets are way too focused on Brexit and economic fundamentals are taking a back seat.

Bank of England

The Bank of England persisted in a wait and see approach at its March monetary policy meeting, citing that uncertainties over Brexit were too great to provide a clear picture to the forces influencing the economy. As expected, the central bank voted unanimously to keep rates on hold at 0.75% and maintained it quantitative easing bond purchases. The bank reaffirmed its flexibility towards changing interest rates by stating that monetary rates could move in either direction as uncertainty continues to loom over the economy. Officials pointed out that should the economy progress in line with its forecasts, then an ongoing gradual and limited tightening would be appropriate.

With the Brexit saga still in play mode, it's logical for the central bank to retain rates at their current levels. Though, the main question is, if a deal is secured, will monetary policy setters rush to reaffirm its previous hawkish stance? Consumer inflation has fallen significantly from around 3.0% in 2018 to the latest reading of 1.9%, which is below the 2% target set by the BoE. Economic figures remain relatively weak. Several central banks including the Fed, ECB, BoJ and SNB are shying away from further tightening, for the UK to be the outlier could put it at risk for making a policy error. Finally, even in a Brexit extension, uncertainty will linger on as the terms of the UK's association with the EU will still have to be negotiated.

As for consumer inflation, the CPI index edged up by 0.1% to 1.9% y/y in February, whereas the core CPI fell by 0.1% to 1.8%. At face value, the slight change in price growth figures suggest little for UK watchers to get too excited about, at least relative to the ongoing twists and turns of the Brexit saga. However, last year monetary policy officials said weak productivity growth since the financial crisis meant that even small increases in wages would lead to higher prices. Overall, with consumer inflation below the 2% objective set by the Bank of England and the Brexit narrative still in play mode; the central bank may prefer to hold interest rates until clarity remerges.

Swiss National Bank

The central bank of Switzerland last week depicted a negative tone towards inflation and monetary policy. The Swiss National Bank lowered its inflation prospects, while maintaining the growth outlook for the current year at around 1.5%. Inflation is anticipated to fall to 0.3% for 2019 and to 0.6% for 2020. These forecasts were at 0.8% and 1.2% just six months ago. The downgrade was made in spite of higher oil prices and a slightly lower franc since the previous meeting in December. As widely expected, the SNB preserved its monetary rates, with the main deposit rate at -0.75% and the 3-month Libor target range at -1.25%/-0.25%. The above rates have been in a constant mode since early 2015.

The Bank stressed that the CHF was 'highly valued', while reconfirming the SNB's readiness for FX interventions to limit the appreciation of the franc if needed. Officials also reaffirmed the importance of negative interest rates. All in all, the dovish tone from the Bank enhances the view that rates will remain on hold for the foreseeable future. Price growth momentum is not expected to rise above 1% until 2021; therefore the Bank can afford to remain patient. The Bank Chairman Thomas Jordan mentioned that increasing global economic risks such as Brexit and US-China trade dispute meant the central bank will stick to its negative interest rate policy for the time being.

In regards to the best performers in the FX market, the safe haven Japanese yen and the Swiss franc appreciated significantly thanks to the Fed's pessimistic tone towards monetary policy. Both currencies are extremely sensitive to US interest rate differentials due to their negative interest rate environment.

Furthermore, feeble economic data out of the euro-zone spurred great demand for safe haven assets. In the past five trading session, the JPY rose by 1.43% versus the USD and 0.82% for the CHF.

Kuwait

Kuwaiti Dinar

USD/KWD opened at 0.30335 on Sunday morning.

Rates – 24th March, 2019

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.1318	1.1271	1.1448	1.1313	1.1120	1.1420	1.1405
GBP	1.3297	1.2949	1.3003	1.3209	1.3020	1.3420	1.3297
JPY	111.50	109.73	111.68	109.90	107.95	110.90	109.15
CHF	1.0022	0.9892	1.0024	0.9935	0.9735	1.0135	0.9854