Weekly Money Market Report

17 February 2019

US Dollar Soars on Congress Approval

United States

Global Economic Data Evidently Frail

The US dollar was among the best performers in the FX market last week despite disappointing data from retail sales and consumer inflation. The dollar's positive trajectory is mainly due to optimism towards averting another government shutdown and weaknesses in global economic activities. In Congress last week, the spending bill passed the Senate by a vote of 83-16 and by 300-128 in the House of Representatives. President Trump is expected to sign the spending bill as his tone towards another government shutdown has dissipated. Trump said that he's not 'happy' or 'thrilled' with the compromise border security deal, but he did not say he would veto it and claimed he does not expect another shutdown. The agreement between Democrats and Republicans gives President Trump $1.375 billion versus his demand for $5.7 billion. However, the President has stated that he plans to announce a national emergency to sidestep Congress and secure funds for his border wall.

In the FX market, the USD gained further support as economic data from the EU, UK and China came in extremely frail. The US dollar index appreciated to a 2-month high last week and gained 0.22% in the last five trading sessions. YTD, the DXY is up around 0.90%.

Weak US Retail Sales Causes GDP Revision

Sales statistics for the month of December disappointed market expectations after retail sales tumbled by the largest amount in nine years and core retail sales also plummeted by the biggest drop since 2001. On a monthly basis, retail sales fell -1.2% and -1.8% for the core figure. The weak report has led the Commerce Department to slash Q4 growth to below 2.0% from 2.7% and at the same time the Atlanta Fed cut its GDP growth estimate for Q4 2018 by 1.2% to 1.5%. US retail sales accounts to around 65% of GDP and therefore the recent figure may pressure growth to come in much lower than previously anticipated.

Looking at the labor market, the 4-week moving average for unemployment benefits is currently at a one-year high. Headline consumer inflation is subdued at 1.6% y/y and producer price growth has fallen in the past two months. Up until the sales data was released, US monetary officials were hesitant to hike rates and based their hesitancy on risks originating from global growth. So, the recent weakness in retail sales further adds cautiousness to the FED's action plan on monetary tightening. US economic data have been delayed due to the longest government shutdown in US history. The delayed reports compiled by the commerce department, including housing starts, new home sales, factory orders and the Q4 GDP are expected be released next week (25-Feb to 1-March).

US Price Growth Further Supports the FED's Wait & See Approach

US consumer inflation disappointed to the downside for the month of January as the annual rate declined to the lowest level since summer of 2017. The CPI rate fell from 1.9% y/y to 1.6% y/y, which may allow the FED to hold the overnight rate at its current level of 2.25-2.50%. On the other hand, the core data remained unchanged for the past three readings at 2.2%. Consumer inflation has been in a sliding state since summer and the CPI has fallen from around 3% to 1.6%, largely subdued by lower energy prices. The price of fuel has fallen by 15.5% over the past three months, including a 5.5% drop in January.

Moderate inflationary pressures have led US monetary officials to remain in a cautious state towards interest rates. Lately, FED officials have indicated a suspension to rate rises, with the Fed chairman stating that the global economic outlook warrants a “wait and see” approach. Price growth has remained tepid despite a robust labor market. It seems that slowing economic growth in China and Europe is pressuring oil prices and causing headline inflation to remain in a moderate stance. Looking at the FED’s preferred data on inflation, the core PCE is currently at 1.9%, which is below the Bank’s target of 2%. Hence, if the negative momentum lingers on, then the central bank has an additional reason not to increase the overnight interest rate.

Europe & UK

Growth in the Single Economy Diminishes

The euro-zone economy grew at a slower pace in the last quarter of 2018, pressured by static growth in Europe’s largest economy, while Italy slipped into a recession. The 19 countries sharing the single currency expanded by 1.2% y/y in Q4 2018, down from 1.6% seen in the previous quarter. The German economy contracted in the third quarter by -0.2% and remained still in the last quarter as growth came in at 0%. Technically, the German powerhouse has avoided a recession by an extremely thin margin, because a recession is defined as two successive quarters of contraction. Looking at the main economies in the euro-zone, Italy contracted by -0.2% q/q, France at 0.3% q/q and growth in Spain held up better at 0.7% q/q. Industrial production in the single economy, which accounts to 25% of GDP is currently in a recession, having contracted in Q3 and Q4 last year.

Economic figures have been consistently poor out of the single economy, while geopolitical tensions in Europe are mounting and growth has diminished around the globe. Moreover, inflation in the euro-zone has been decelerating and weaker demand may further subdue inflation prospects. Therefore, the recent trend in data suggests that the European Central Bank could retain its current monetary strategy and an interest rate hike seems farfetched.

Looking at the euro, the currency has been under selling pressure over the past week largely driven by heightened concerns over the health of the euro-zone economy. The latest data flow has surprised significantly to the downside. The slowdown during the second half of last year seems to have prolonged into early this year. The perseverance of economic feebleness has challenged the view that growth was being held back by temporary factors. It leaves the euro-zone economy more vulnerable to further negative shocks. The euro declined to almost a three-month low to 1.1231 and lost 0.24% of its value to the US dollar. YTD, the EUR/USD is down by 1.21%.

UK Growth Rate Slowest in 7 Years

The deterioration of economic data out of the UK has become more evident as the economy in 2018 grew at the slowest pace since 2012. Forward looking indicators are also suggesting that growth has remained frail or even weakened at the start of the year. On a quarterly basis, the economy expanded by a mere 0.2% in Q4 2018 from 0.6% seen in Q3 2018. It is clear that the Brexit theme is the main culprit for the poor reading. Business investment tumbled in every quarter of 2018, and declined by an annual rate of -3.7% in Q4. Industrial production contracted by -0.5% m/m while manufacturing output came in at -0.7% m/m.

The uninspiring data at the end of last year puts the economy in a tough start for Q1 2019 and suggests the UK needs to see greater monthly increases to boost the quarterly growth rate. Therefore, it poses a down side risk for the economy and the Bank of England lowered its prospects to 0.2% for the current quarter. Moreover, the Bank also predicted that the British economy has a 25% chance of entering into a recession by the summer. Overall, Brexit continues to be a drag on the economy and if the uncertainty surrounding Brexit persists, then firms and investors are likely to further refrain from investing.

UK Consumer Inflation in a Persistent Decline

Britain's price growth momentum has been on a downward trajectory for the past three readings and January's consumer inflation data has fallen below the 2% mark for the first time in two years. The annual CPI rate disinflated by 0.3% to 1.8%, while the core CPI that excludes volatile swings from energy and food related products remained unchanged at 1.9%. Hence, it is evident that the lower headline inflation is mainly due to a fall in gas, electricity and petrol prices. The Office of Gas and Electricity has initiated a cap on energy related products and services since the start of the year.

The continuous decline in inflation supports the BoE's policy of maintaining a wait and see approach on interest rates and the outlook on interest rates is largely dependent on Brexit negotiations. As for the Bank of England's projection, the Bank expects consumer price growth to remain just below the 2% target for the first quarter of the year. Therefore, if wage growth remains stagnant at the pace registered in November, the fall in January's price growth would push real pay growth up to 1.4%, the fastest since 2016. This may assist the economy as household consumption increases.

The Sterling pound has been trading in a negative manner pressured by mounting Brexit uncertainties and the 29 March deadline is right around the corner. Moreover, economic data fails to bolster confidence in the economy. Last week, PM May suffered another loss as her Brexit Plan B was crushed in Parliament by 303 to 258. The Prime Minister barely has time to reach a Brexit settlement with the EU, win MPs' support and implement legislation in parliament, so that Brexit can take place as scheduled on March 29. There is obviously a threat that a No Deal Brexit could intensify in the weeks ahead as time is quickly running out before the end of the Article 50 period. Hence, the GBP may endure further volatility until clarity towards Brexit emerges. The GBP lost 41 basis points to the US dollar last week and closed on Friday at 1.2888.

Asia

Disinflation in China

Consumer prices in China disinflated to more than a 1-year low and at the same time producer inflation has fallen for the seventh consecutive reading. The CPI rate for the month of January came in at 1.7% y/y, down from 1.9% y/y. As for the PPI, producer price growth is currently at the lowest level since 2016 at 0.1% y/y. The inflation figures suggest that demand has remained relatively weak at the start of the year and is a concern for the profitability of the industrial sector as there is a high correlation between inflation and profitability. Hence, China could further ease monetary and fiscal policies to support the economy, especially with weaker growth in China and around the world.

Japan's GDP Recovers from Contraction

Japan's economy recovered from a contraction in the fourth quarter of 2018 as the economy expanded at an annualized rate from -2.5% in Q3 to 1.4% in Q4. The GDP data has recovered, however Japan is still an economy that is losing momentum. The economy grew at a pace of 0.7% in 2018, compared to 1.9% in 2017. The central strain on Japan's economy is coming from overseas demand, with economic weakness in Europe and a slowdown in China negatively impacting Japan's export sector. The trade war theme between the two largest economies is also seen as a major burden for Japan's exports of cars, electronics, and heavy machinery to China.

On the inflation front, core price growth has remained extremely muted in Japan especially with falling oil prices globally. The latest core CPI rate is at 0.7%, the lowest level since May 2018. As for the BoJ's preferred measure of price momentum, the rate is at 0.3%, failing to register any acceleration since August 2018. That being said, the central bank is likely to maintain its loose monetary strategy with GDP neither strong enough to encourage monetary tightening, nor frail enough to create pressure for further stimulus.

The safe haven Japanese yen weakened versus the USD as the US government averts a shutdown and trade tensions are easing. Trump's aggressive tone towards China is receding and both countries seem to be working in collaboration to avoid further tariffs on each other. The USD rose by 0.53% against the JPY in the past five trading session.

Kuwait

Kuwaiti Dinar

USD/KWD opened at 0.30365 on Sunday morning.

Rates – 17th February, 2019

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.1320	1.1231	1.1344	1.1293	1.1115	1.1385	1.1385
GBP	1.2929	1.2770	1.2957	1.2888	1.2675	1.2990	1.2959
JPY	109.86	109.76	111.12	110.44	109.60	112.50	109.71
CHF	0.9995	0.9991	1.0098	1.0052	0.9950	1.0240	0.9969