Treasury Group
Weekly Money Market Report
22 January 2017

The First 100 Days Test

United States

Welcome to Trumpland

The past ten US presidential terms show that there is a tendency for markets to turn very optimistic and record gains at the end of the first 100 days of a new administration; a period called the honeymoon of the president.

This time, as we went into Trump's inauguration, markets were rapidly disappointed by the speech of the new president that didn't waste any time and directly invoked protectionism and placing America first. The negative tone of the speech came as a surprise to many analysts who expected a more uplifting message relative to the campaign rhetoric.
This is why, for the moment, markets continue to fade the two months old Trump rally as a growing number of analysts have cautioned and voiced out that a trade war between the US and its major trading partners could be negative and likely to drag the global economy into a major recession.

Locally, with the US economy approaching the Federal Reserve's dual mandate of full employment and price stability, Fed Chairwoman Yellen cautioned this week against allowing the US economy to run "hot". With monetary policy still modestly accommodative, she mentioned that the Fed should continue to raise interest rates slowly. "I think that allowing the economy to run markedly and persistently "hot" would be risky and unwise," Yellen said. "I consider it prudent to adjust the stance of monetary policy gradually over time," she added. Regarding the labor market she said: "In the coming months, I expect some further strengthening in labor market conditions as the economy continues to expand at a moderate pace."

Yellen also suggested that the idea to expand the US economy with fiscal stimulus is preferable when there is more slack in the labor force. A fiscal support by President Donald trump could boost demand for workers in areas where labor is already tight. That in turn, could fuel inflation, force the Federal Reserve to raise rates faster than expected, and increase the probability of another recession

In parallel, the events in Europe did not provide any market excitement as the ECB left interest rates unchanged as expected with Draghi's statement and press conference after the announcement sent initially the Euro lower despite him saying that he didn't want to get drawn into the currency race to the bottom. His tone was however dovish with no mention of tapering. The currency losses were later pared as markets digested what was said and realized that not much had changed. Perhaps Trump's statement that the "Strong dollar is killing us", also incited investors to move out of the Dollar even with Yellen remaining on the hawkish side.

On a different sensitive topic as of late, the UK Prime Minister May stated this week that the country "cannot possibly" remain within the European single market, as staying in would mean not leaving the EU at all. The speech confirmed the Government's intention to pull out of the single market when Britain leaves the EU, ending months of uncertainty and confusion following the June referendum. With her speech, May finally pulled the plug with a 12-point plan for leaving the EU, two months before she pulls the two-year exit trigger Article 50. She also announced parliament would get to vote on the final deal agreed between the UK and the EU.

In addition to Mrs. May's speech, Bank of England chief economist and member of the Monetary Policy Committee Andy Haldane admitted that the Bank was wrong on Brexit. Stating that If we were to look at how the British consumer performed in the course of last year, it's almost as though the referendum had not taken place.

On the currency front, the US dollar index opened the week at 101.47 and fell on Tuesday to a one month low of 100.26, after Trump said the US dollar is too strong and a weak Chinese Yuan was negative for the Dollar. The major events of the end of the week didn't help sending the dollar down to close on Friday at 100.81.

Sterling Pound started the week deep into negative territory at a 3-month low of 1.1979 against the dollar as fears of a hard Brexit gained control of the market. However, May's speech on Tuesday helped remove markets' uncertainties confusion, and helped squeeze out investors who were betting on another collapse of the currency. The currency soared almost by 2.6% the largest one day up move since 2008 after Prime Minister Theresa May promised a parliamentary vote on Britain's deal to leave the EU. The currency closed the week at 1.2374.

In the commodities complex, gold prices started the week around the $1,200 level surging to a 40-day high of $1,218.64 on Tuesday after US President-Elect Donald Trump complained about a strong dollar. Gold prices remain supported into the New Year on the back of numerous uncertainties surrounding global affairs.

Manufacturing Indices Showing Signs of Fatigue

The general business conditions for the state of New York retreated from an 8-month high of 7.6 in December to 6.5 in January as American factories activity have been pressured by weaker global demand, a strong dollar that makes US goods more expensive abroad and an energy rout that has led oil-sector firms to slash budgets. Shipments and new orders remained positive on the other side and inventories edged higher for the first time in more than a year.

Although disappointing, the overall data is likely to keep a positive mood towards the overall manufacturing outlook and the main feature is evidence of a further increase in inflationary pressures. This will also keep the Fed stay on high alert over inflationary trends. Although there was no immediate evidence that a stronger dollar has curbed inflationary pressure, new orders index nonetheless could indicate some impact that is likely to grow if the new administration adopt protectionist policies and get into potential trade wars.

Moreover, the Philly Fed manufacturing outlook strengthened to a 24-month high, maintaining a confidence in the manufacturing sector. Most manufacturers in the Philadelphia region expect business to be better six months from now. In summary, the current manufacturing index accelerated from a revised reading of 19.7 in December to 23.6 this month. Forty percent of the firms reported increases in activity this month and 17% reported decreases. The general activity index has remained positive for six consecutive months.

Europe & UK

Draghi Keeps the Status Quo

The European central bank stayed on the sideline with its loose monetary policy on Thursday, with the refinancing rate at 0% and its deposit rate at minus 0.4%. The asset purchases will persist at EUR 80 billion a month until the end of March and then at EUR 60 billion a month from April to December, or beyond, if necessary. The central bank sets its policy with the goal of reaching an inflation rate close to 2%. It has missed this goal for nearly four years and its own predictions see it still missing that goal in 2019. But inflation has started to rebound, hitting 1.1% in December, the fastest rate of growth since September 2013.

Optimistic Business Confidence in Germany

The German economic sentiment brightened at the start of the year and improved to its highest level in seven months in January, although the data was less than what analysts expected. The slight increase is attributed to the improved economic situation across the European continent. In details, the German economic sentiment rose to 16.6 points in January from 13.8 in December versus a forecast of 18.9.

While the Unemployment Continues to Decline, 2017 is likely to be difficult for the UK

For the past few months, the UK Prime Minister allowed uncertainties around the trigger of Article 50 and the degree of the sought separation from the EU. The subject matter was so confusing that many in other European capitals questioned whether Britain would leave at all.

This week, May finally confirmed that Britain will leave the single market and the customs union, and will thus be able to negotiate its own trade deals with third party economies.
Moreover, she expressed her wishes to wrap up the negotiations within the two years permitted by Article 50, launching the exit process by the end of March.

On the economic data, cost of living in Britain soared to the highest rate in two-and-a-half years due to the pound’s 20% drop since the "Brexit" vote which continues to push up costs in the UK. The Official figures for December showed the increase in air fares, food prices and fuel costs all helped to drive the CPI to 1.6% from November’s 1.2%. Separate producer price inflation figures showed that the price of goods bought from factories rose 2.7% in December compared with a year ago, as manufacturers started to pass on the higher input costs to their customers. Furthermore, the prices paid by factories for raw materials and energy jumped by 15.8% over the year, the largest increase since September 2011. In conclusion, it is likely that the UK starts to feel the overall economic impact of Brexit in 2017 with the rising inflation fuelled by a weaker currency and higher energy prices. Add on this the Brexit negotiations, this year is likely to test the UK economic resilience.

Despite the ongoing uncertainties, November was another strong month for the labor market in the UK with unemployment rate remaining for a third consecutive month at its lowest level for more than a decade at 4.8%. The number of individuals in the work force however has also fallen for a second consecutive report, the first back-to-back fall since mid-2015. In three months to November, unemployment decreased by 52,000 to 1.6 million.

Asia

China’s GDP Grows for the First Time in 2 Years

China's economic growth slightly increased for the first time in two years in the final quarter of 2016, supported by government spending and cheap credit, giving the country some breathing room heading into what is expected to be a volatile 2017.

Despite the better than expected fourth-quarter supported by a massive wave of government stimulus, debt and low interest rates, it is still the sixth successive year the economy has slowed and the lowest annual GDP growth recorded in 26 years.

In details, the economy grew 6.8% on a yearly basis in the fourth quarter of 2016, above market expectations and driving 2016 growth to 6.7%, within the 6.5 to 7.0% range targeted by the government. Growth was mostly helped by internal consumption growing close to 10% on a yearly basis, whereas industrial production remained stable around 6%. Fixed-asset investment continued to be a negative component of growth and further decelerated over the course of the year. Meanwhile, retail sales rose 10.9% against 10.7% expected for December and industrial production grew 6.0% against expectations of 6.1%. Nevertheless, the Chinese data released failed to give a significant boost to commodity prices in the beginning of 2017.

Japanese Policymakers Promoting a Strong Relation with the US

According to Japan’s finance minister, the country wants to communicate closely with the new US administration under incoming President Donald Trump in order to maintain stability in currencies. Aso also stated that he won't fret about every single currency move, while adding that it was desirable for currencies not to fluctuate wildly

In parallel, Bank of Japan deputy governor Nakaso also spoke this week stating that while the Japanese financial system remains stable, he reiterated that the responsibility of the central banks was to ensure that its monetary policy action does not destabilize international financial system. He also mentioned that it was important to monitor, analyze carefully the dollar funding environment of non-US banks as an area of potential vulnerability of the global economy.

Finally, Bank of Japan Governor Haruhiko Kuroda said that the prospects of faster US growth may push up the dollar, and he offered an upbeat view on the world economy, dismissing concerns that protectionism could spread and undermine global trade. According to Kuroda, "growth in the US.” economy is likely to accelerate this year and next year, and price inflation may rise somewhat. All of this may make interest rates rise and the dollar might also appreciate."

On the exchange rate, he mentioned that "exchange rate movement is very difficult to predict. You cannot say anything definite because exchange rates are affected by so many factors, not just interest rates and economic growth."

Finally, Kuroda dismissed concerns that incoming US President Donald Trump's policies and European elections this year could trigger a global tide of protectionism and hurt world trade. "Most countries, including the G7 and G20 major economies are strongly committed to promoting global trade, and so can help prevent protectionism from spreading."

Kuwait

Kuwaiti Dinar at *0.30515*

The USDKWD opened at 0.30515 on Sunday morning.

Rates – 22 January, 2017

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.0621	1.0578	1.0718	1.0699	1.0515	1.0870	1.0755
GBP	1.1979	1.1979	1.2415	1.2374	1.2135	1.2590	1.2411
JPY	114.41	112.55	115.61	114.60	112.55	116.90	114.19
CHF	1.0103	0.9992	1.0136	1.0012	0.9845	1.0215	0.9973