Treasury Group

Weekly Money Market Report

18 March 2018

Markets Trajectory Dictated by US Politics

United States

Safe Haven Yen in Demand

Recent inflationary figures out of the US were not too hot, neither too cold, but just enough to fortify the outlook for three interest rate hikes this year by the Federal Reserve. The inflation data from the US last week strengthened market sentiment temporarily, with S&P 500 futures rising and bond yields dipping. The inflation report was neutral enough that it was swiftly dominated by political turbulence in Washington when President Donald Trump fired Secretary of State Rex Tillerson. US stock markets immediately reversed gains. The absence of a major upward surprise in the inflation numbers may assist equity and bond markets to find some calmness after markets were shaken by January's labor report which showed wages rose much faster than anticipated. With inflationary fears out of the way US political turmoil continues to overshadow the goldilocks era in America, which the equity market cherished.

Looking back at the dollar's trajectory, the green back continued to maneuver in greater response to political issues than economic fundamentals. The continuous shift in crucial employees at the White House is elevating concerns that the current administration could pursue an even more aggressive and protectionist policy agenda moving forward. Donald Trump's top economic adviser Gary Cohn resigned following Trump's pronouncement to enforce tariffs on steel and aluminum imports, a move Cohn and the treasury secretary have strongly opposed. Moreover, Reuters reported that President Trump is pursuing to impose tariffs of up to $60 billion on Chinese imports and will target the technology and communication sectors. Politico reported that US Trade Representative Robert Lighthizer offered Trump a package of tariffs targeting $30 billion a year on Chinese imports. However, the president insisted on a greater number. It's not a surprise that investors are demanding a greater risk premium for Dollar investments.

As for the ECB's president, who cited last week that the present monetary strategy will remain cautiously loose despite increased confidence on the future path of inflation, therefore further upside price growth data is needed. The conclusion from the remarks of Draghi and Chief Economist at the ECB was that additional inflationary signs are desired before policy setters press the brakes on the loose monetary approach. Policy rates will need to persist at their present altitudes well past the end of net asset purchases until then. Thus, the first interest rate rise is not expected until around the middle of 2019.

Since the start of the year, currencies around the globe haven't hesitated to take advantage of the Dollar's weakness. Draghi stressed on the issue by stating the Bank remained alarmed about the strength of the euro that is not fully backed up by improving economic fundamentals in the euro-zone but more by external factors according to the ECB's analysis. External factors such heightened political instability in the US have been more important drivers of the stronger euro at the start of this year, even as fundamental economics favors a stronger green back.

Last week in the FX market, the Dollar index was on the back foot after Secretary of State Rex Tillerson was removed from office by President Trump. Moreover, the possibility of additional import charges against China played a roll too. The downward momentum in the index persisted until Thursday when the Dollar was saved by the robust Empire State Manufacturing figure. The USD index ended Friday's session at 90.139, almost unchanged over the week.

The single currency was in a hawkish mode at the start of the week as the US dollar was subdued. It was a light week in terms of economic data for the euro-zone, hence the euro's direction was mainly correlated with US dollar movements. The euro also managed to close the week were it started off, at 1.2287.

It was a different story for the Sterling pound. The pound was one of the best performing currencies last week supported by some renewed optimism over ongoing Brexit negotiations. UK junior Brexit minister Robin Walker stated that "we recognize how important it is to secure the deal on the implementation period as soon as possible. I want to stress that we are very close to a deal at this time". On the EU side, an unnamed diplomat was quoted saying "the UK was seriously prepared", and that "means let's get on with it". The GBP gained 0.62% over the USD last week.

Safe haven yen continues to be in demand as investors are worried about global trade tensions and high turnover rate at the White House. The yen encountered some weakness on Tuesday pressured by political scandal surrounding

Prime Minister Shinzo Abe's government, however the weakness was short lived. The Japanese yen has already appreciated 6% versus the US dollar in 2018 and as geopolitical risks continue to mount that opens further room for the yen to increase. The USD depreciated by 0.94% versus the JPY in last week's session.

In the commodities complex, the precious metal was consolidating throughout last week as global trade tensions were matched by expectations that the FED will hike interest rates next week on March the 21st. Gold closed the week at $1313.

US Inflation

Both headline and core consumer price growth accelerated by 0.2% on a monthly basis in February, in line with earlier projections. In annual terms, consumer inflation came in at 2.2% from 2.1% recorded in the previous reading, while the core data remained stagnant at 1.8%. The inflation data came after the latest jobs report, which showed wage growth remained subdued. Combining both wage and consumer inflation data together decreases the probability for US policy makers to speed up the pace of monetary tightening. For the core figure to pick up more significantly and raise the pace of overall inflation, wages need to accelerate. The main theme was that core inflation remained unchanged. The data will have little impact on this month's FOMC meeting, at which Fed Chairman Jerome Powell is broadly expected to raise rates by 25 basis points.

On the producer front, prices in the wholesale market progressed to an annual rate of 2.8% from 2.7% in January as the PPI increased by 0.2% m/m. The robust inflationary data however was in the core figure that excludes food, energy and trade services grew 0.4%, matching January's gain. In the 12 months through February, core PPI increased 2.7%, the biggest gain since August 2014.

Consistency in Negative Retail Sales Data

Growth in US retail sales has been sluggish recently with sales deteriorating for a third consecutive month, the sequential occurrence of such negative data has not transpired in nearly six years. One reason why overall retail sales have weakened recently relates to reduction in auto sales. Auto sales surged to a high of 18.5m annually last September, due to a wave of replacement purchases for vehicles that were damaged by Hurricanes Harvey and Irma. Since then, auto sales have dropped back, slowing to 17.0m. The Commerce Department concluded that retail sales slipped 0.1% last month, while the core data rose by 0.1%. After persistent negative data in retail sales, which accounts to a significant portion of US GDP, the Atlanta Fed reduced its estimate for Q1 growth to a 1.9% annualized rate from an earlier estimate of 2.5%.

Europe & UK

Euro-zone Price Growth Disappoints to the Downside

February's consumer inflation figure declined to an annual rate of 1.1% from 1.3% seen in the previous month. In the same month last year, the rate was 2%. The fall back in the headline data is attributed to deflation in unprocessed food prices and declining energy prices, data from the European Union's statistics office Eurostat showed. The core figure remained unchanged at 1%. On the wages front, annual hourly labor costs growth slowed from 1.6% in Q3 to 1.5% in Q4. Overall, the central banks goal of a widespread rise in underlying inflation is no wear to be seen and although the Bank may end its bond buying program at the end of 2018, increasing interest rates in early 2019 seems less likely.

SNB Decreased its Inflation Expectations

As anticipated, the Swiss National Bank sustained its policy rates (sight deposit rate at -0.75% and 3-month Libor target range at -1.25%/-0.25%) that were implemented in early 2015. The slight surprise was that the SNB revised down its inflation estimates by 0.1% for 2018 and 0.2% for 2019, while maintaining its growth forecast of 2% for the current year. The modification of inflation projections is due to the appreciation of the CHF. As a result, the central bank described the franc as highly over valued and stressed once again the significance of negative rates and FX interventions to curb the currency's strength. They expect inflation to reach 2% in late 2020, thus policy rates may not tighten before 2019.

Asia

BoJ's Meeting Minuets

Meeting minutes from the Bank of Japan revealed most monetary policy makers on the board share the view that the current strategy should persist due to the lack of inflationary pressures. The Governor articulated the Bank could engineer a smooth withdrawal from its easy monetary policy. However, it is too early to debate specifics with price growth still distant from its target. Inflation is barely above 1%, so the BoJ is in no urgency to scale back stimulus even as the costs of prolonged easing mount. In regards to Japan's public debt, the current monetary strategy has greatly enhanced the country's debt making it more challenging to maintain the current policy rate. Sluggish wage upturns have become the main drag on BoJ's efforts to raise inflation even as the government forced corporations to elevate employee salaries.

Robust Data out of China

Industrial production and fixed asset investment incurred a robust start for the current year, with advancements for both measures coming in above estimates. In the first two months of the year, industrial output accelerated to a six months high of 7.2% annually, up from 6.3% in 2017. The positive shift is attributed to strong production in machinery, equipment and electronics. High-tech merchandises saw robust annualized growth of 25.1% with a 178% increase in volumes. Looking at fixed asset investment, the figure grew 7.9% year on year from 7.2%. Higher investment also coincides with the improving expectations component of the PMI survey, with greater future demand is expected and therefore more investment plans to go ahead. Economic forecasters had projected a slight decline due to a crackdown on heavily polluting industries. But the data showed otherwise as steel production rose to its highest in months.

On the domestic front, resilient durable goods transactions advocate resilient domestic demand and online sales continues to fire away, reaching the highest level in 31 months. The relentless drive in sales of online services suggests industrial upgrading in traditional services is evidently taking off. In details, retail sales expanded 9.7% from 9.5% recorded last year.

Overall readings ranging from output to property investment to business surveys indicate acceleration has picked up so far this year, keeping a harmonized global recovery on track. In regards to monetary policy, moderate growth, limited inflationary pressure, lending rates on bank loans are already moving higher through tighter regulations and liquidity provisions since last year. As a result, markets remain neutral on monetary policy stance from the People's Bank of China.

Kuwait

Kuwaiti Dinar at 0.29990

The USDKWD opened at 0.29990 on Sunday morning.

Rates – 18 March, 2018

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	High	Low	Close	Minimum	Maximum	Forward
EUR	1.2909	1.2412	1.2259	1.2287	1.2090	1.2505	1.2375
GBP	1.3851	1.3996	1.3838	1.3939	1.3715	1.4145	1.4009
JPY	106.80	107.29	105.59	106.00	104.20	107.95	105.30
CHF	0.9492	0.9547	0.9421	0.9520	0.9315	0.9715	0.9443