Treasury Group

Weekly Money Market Report

23 December 2018

Fed Delivers Fourth Rate Hike of 2018

United States

Fed defies President Trump

After long talk of a fourth interest rate hike before the end of the year, the Federal Reserve finally announced its intention to march ahead with a 25 basis point increase in rates. Despite calls by President Donald Trump for the Fed to stop raising interest rates, the latter stuck by its plan to keep withdrawing support from an economy it views as strong. Traders felt uneasy by the decision, as evident in the sharp drop in US equities and bond yields.

Markets are skeptical

Even though the Fed signaled “some further gradual” rate hikes and its intention to continue to cut its massive bond portfolio, interest rate futures revealed that traders do not buy this claim. Markets are currently betting the Fed won’t raise interest rates at all next year.

However, Federal Reserve chairman Jerome Powell did acknowledge the recent “softening” in global growth, tighter financial conditions, and expectations the US economy will slow next year. In that case, he admitted the policymakers can be “patient”.

The US government was shut down last week after the standoff over Trump’s $5 billion border wall with Mexico was not approved by congress. With no deal in sight on a bill to fund the government, US senators were sent home until Thursday. The quarter of the federal government programs (Departments of Homeland Security, Justice, Agriculture, Parks and Museums) will not be funded up until a deal is concluded in congress. In details, 400,000 federal employees in those organizations will work without pay and another 380,000 will be on temporary leave also without any wages.

Fed intends to continue policy normalization

Nonetheless, Powell asserted that the Fed will continue to trim its balance sheet by $50 billion each month. Furthermore, he also revealed that the Fed could be forced to raise rates to the point where they start to hinder the economy’s momentum should the strong economic numbers continue in the future.

Overall, the Federal Reserve believes the US economy continues to perform well and no longer requires the Fed’s support either by maintaining a large balance sheet or through lower than normal interest rates. “Policy does not need to be accommodative,” insisted Powell.

Sharp reaction from investors

Global equity markets did not take kindly to the hike. In fact, US equities experienced their worst reaction to a Fed rate hike since 1994, when the Fed raised hikes by 2.5% in a single year. The Dow Jones, NASDAQ, and the S&P 500 were all down by 1.5% or more as the central bank marched on with a rate raise despite signs pointing to faltering global economic growth. World markets followed suit, as MSCI’s global equity index fell to its lowest since May 2017, shedding nearly 1.5%. This sentiment was also shared in Asia, where the Bank of Japan decided to keep interest rates on hold as global economic risks continued to mount. The Topix benchmark entered bear market territory, where it is now down by more than 20% from its January high.

Investors fleeing the equity market found shelter in safe government bonds. Treasuries rallied as the yield on the 10-year US Treasury fell by more than 2% to its lowest level in eight months after the rate decision. German 10-year government bond yields, the euro zone benchmark, fell to their lowest in nearly seven months. Other high grade euro zone bond yields also fell.

Fed hike adds to oil woes

Meanwhile, oil prices dominated headlines after suffering heavy losses last week. Since the October high, prices have now fallen more than 35%. OPEC and Russia's agreed additional production cuts have failed to stop this downward trajectory of prices. At the same time, weaker prospects for oil demand amid a possible slowdown in the global economy have raised concerns about an oversupply, calling into question the effectiveness of the aforementioned supply cuts. Moreover, the lingering trade war worries between the two largest economies continue to pressure oil prices. Adding fuel to fire, the US continues to ramp up production and has beaten Russia and Saudi Arabia as the world's largest oil producer for the first time. US output now stands at a record 11.7 million barrels per day. Finally, an interest rate hike in the US added to the attraction of the dollar, which maintains an inverse relationship with oil prices.

UK & Europe

No-deal Brexit increasingly likely

With less than 100 days to go until Brexit day, the prospects a no-deal Brexit have jumped especially since Theresa May's deal is struggling in Parliament. Accordingly, the government has stepped up plans to prepare for such an event. A part of this plan, which was revealed last week, included putting 3,500 military personnel on standby to "to support any government department on any contingencies they need". The Ministry of Defence said the personnel, who will include engineers, mechanics, and drivers mostly drawn from a number of army regiments, will be ready to be deployed for any crisis if the UK crashes out of the EU without an agreement being signed.

Businesses and politicians do not share priorities

The plan also includes dispatching 80,000 emails to company executives explaining how to deal with customs and regulatory changes in the event of no deal. Consequently, the UK's five leading business groups proceeded to attack the "managed no-deal" Brexit. In a joint statement, the five groups — the British Chambers of Commerce, the CBI, the EEF manufacturers' organization, the Federation of Small Businesses and the Institute of Directors — said they had been "watching in horror as politicians have focused on factional disputes rather than practical steps that business needs". The statement added that "the suggestion that 'no-deal' can be 'managed' is not a credible proposition. It is clear there is simply not enough time to prevent severe dislocation and disruption in just 100 days."

Preparations to mitigate chaos

On the other hand, Brussels also ramped up efforts to attempt avoiding the worst of a no-deal Brexit. The European Commission unveiled a package of 14 contingency proposals that included measures to ensure uninterrupted flights between Europe and the UK, and to retain EU citizens' access to the City of London. The package however does not include the side deals to Britain that some Brexiters are confident will be available. Amongst other disruptions, the EU expects unprecedented border queues and diminished flight schedules to be some of the immediate consequences of a no-deal Brexit.

BOE maintains its benchmark rates

In its latest meeting, the Monetary Policy Committee voted unanimously on keeping rates on hold without making any alterations to the amount of money printed under its quantitative easing program that followed the global financial crisis. The Bank of England left interest rates unchanged at 0.75% as it warned that Brexit uncertainties had “intensified considerably” during the last month. For the first time in its history, and with little idea whether the UK was going to leave the EU smoothly or crash out in March. The MPC gave no indication of how recent data were shaping its thinking on monetary policy, what it gave was merely a repetition of what it said at its November meeting. Reiterating that if there was a smooth Brexit with a transition period, the economy was likely to need roughly one quarter-point interest rate rise a year to keep inflation anchored to its target of 2%.

Kuwait

Kuwaiti Dinar

USD/KWD opened at 0.30370 on Sunday morning.

Rates – 23rd December, 2018

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.1305	1.1299	1.1486	1.1372	1.1175	1.1570	1.1470
GBP	1.2579	1.2571	1.2707	1.2645	1.2435	1.2835	1.2741
JPY	113.35	110.81	113.52	111.21	109.35	112.25	110.43
CHF	0.9961	0.9841	0.9987	0.9952	0.9755	1.0145	0.9870