Weekly Money Market Report
21 October 2018

The FED Asserts its Independence

United States

Dollar Rallies after FOMC's Meeting Minutes

Nervousness around the globe has intensified recently in an era of elevated US debt costs, a weakening economic outlook around the globe and escalating geopolitical tensions has equity markets embracing the red zone. Brexit vagueness, frailer GDP data out of China and tensions between Italy and the EU over the Italian budget are amongst the issues at present concerning investors. Despite rising treasury yields, the yellow metal performed relatively well as investors demand for safe haven assets increased. Last week, the price of gold rose $7 to $1,225.86.

In regards to the FOMC's latest meeting minutes, central bankers depicted the continuous recurring theme of gradual interest rate hikes and nearly all members claimed minimal changes in their valuations of the outlook for economic growth. As for the Bank's main benchmark interest rate, forecasts indicated an increased agreement among the members of the policy committee to elevate rates for a fourth time this year in December. Most members on the committee still foresee three additional hikes in 2019 and one more surge in 2020, ending at a key level of 3.375%. Overall, the minutes showed two participants asserting disapproval towards moving monetary policy into restrictive mode (interest rate greater than about 3%).The minutes did not register any debate among officials about President Trump's condemnation of elevated debt costs, indicating that policy setters are not fazed by it.

The greenback appreciated as the 2 and 10-year treasury yields moved higher after the release of the meeting minutes. Hence, one might have expected a hawkish tone to be the content of the report. However, that wasn't really the case with nearly all members noting minimal adjustments in their valuations of the outlook for economic growth. Possibly what attracted the market's attention was that a few participants had seen data that indicated the economy was sturdier than previously projected. The central bank's forecast for growth this year was increased from 2.8% to 3.1%, although this really isn't fresh news. What is worth noting is that in spite of the robust growth, the FED upheld its assessment of growth at 2.0% in 2020. So, the Federal Reserve in fact expects a sharper slowdown over the forecast period.

US Retail Sales

Retail sales disappointed to the downside for the month of September as headline sales edged up by 0.1% m/m versus an expected forecast of 0.6%. The latest figure matched August's surprisingly soft 0.1% rise, which was the weakest expansion for the gauge in six months. The main factor that attributed to the frail reading was from the biggest drop in spending at restaurants and bars in nearly two years. Transactions at restaurants and drinking establishments fell by -1.8% m/m, compared to a monthly average rate of 0.8% over the past year. Despite weaker than expected sales, core sales expanded 0.5% m/m, higher than the 0.4% anticipated by economists.

The robust core number suggests that consumer spending remains firm, which may offset anticipated drags on economic growth from a widening trade deficit and persistent weakness in the housing market. The latest estimate for Q3 retail sales is 3.5% annualized, slightly below the 3.8% pace registered in the April-June period. Annualized GDP projection for the third quarter is currently above 3%, while the economy grew at a 4.2% pace in the second quarter. Overall, the largest economy in the world continues to defy the global speed of growth recorded in other developed nations. The unemployment rate in the US is at 3.7%, the lowest since 1969 and the FED is the first central bank to win the race of achieving its price stability objective compared to its peers.

Looking at the FX market, the US dollar was trading in a weak manner at the start of the week as retail sales data disappointed to the downside. However, the downward momentum was short lived after the FOMC reaffirmed its hawkish stance on interest rates. Higher US Treasury yields fortified investors' preference to purchase the greenback. Markets are becoming more bullish on USD short-term outlook, especially against emerging market currencies as US debt costs are expected to rise, while global trade tensions show no sign of exhaustion. The DXY gained 0.34% over the past 5 trading sessions.

UK & Europe

The Euro Pressured by Italy's Government Budget

It was an extremely light week in terms of economic indicators for the euro, however last week was loaded with political tensions in Europe. The outcome from the German election has caught some market attention although the impact on the euro was limited. The Christian Social Union, the conservative sister party of German Chancellor Angela Merkel's Christian Democrats managed to secure the election with only 35.6% of the vote, their worst result since 1950. Five years ago, the party had 48% of the votes. Moreover, the latest EU summit was a nonevent as both the UK and the EU failed to conclude a Brexit deal. The single currency was further subdued towards the end of the week when the European Commission claimed that Italy's 2019 budget draft is in severe breach of EU budget guidelines. The EUR lost 37 basis points to the USD last week.

UK's Real Household Income Improves

As the Bank of England prepares itself for the Inflation Report on November the first, the most recent wage growth may add to the already relatively hawkish sentiment on the committee. In details, wage growth excluding bonuses inflated to the highest level since January 2009, coming in 3.1% higher than a year earlier in the three months to August. Wages including bonuses also followed the upward momentum, rising from 2.6% to 2.7%. BoE member Dave Ramsden stated that 3% pay growth is consistent with a 2% CPI inflation target, hence the British economy is running above its inflation target. In addition, the surprisingly strong GDP number in the three months to August rose better than expected to 0.7%, this could lead the MPC to sound more hawkish. Unemployment diminished by 47,000 to 1.36 million in the three months to August. The jobless rate remained at 4%, a 43-year low.

On the consumer front, price growth experienced disinflation as the CPI declined from 2.7% to 2.4%, a three months low. The up-tick in wages with a slower increase in CPI enhances consumers' real take-home pay checks, which paints a brighter picture for UK retailers. At the moment, there is an 18 basis point interest rate hike priced in for May 2019, with a full hike (25bps) priced for August 2019. Subsequently, the market is pricing another rate rise in summer 2020. Estimates are roughly in line with one hike a year, which the BoE has guided towards. However, all expectations are still subject to considerable uncertainty around the Brexit process. Additionally, expectations were revised dramatically in the past year due to the Brexit environment.

As for the sterling pound, GBP/USD began the weekly session on a strong footing reinforced by robust wages, which came near a decade high. After rising to a 4-day high of 1.3235 on Tuesday, GBPUSD lost its momentum as consumer inflation came below expectations. The pound was also pressured down on undesirable Brexit news. Unsuccessful British tactics to secure a Brexit deal ahead of a key European

Union summit strengthened global investors' preference for safe haven currencies. The pound closed the week lower at 1.3070.

UK Sales Cool off as Summer Ends

Sales at British retailers dropped more than expected to -0.8% in September. After the relative strong retail sales in the previous two months, a drop back was somewhat anticipated. Even though the extent of this fall was greater than projected, it is not outside the normal range. A 1.5% decline on a monthly basis in food store sales accounted for nearly the entire decline in total sales. Over the quarter, sales growth has decelerated to 1.2% in Q3, from 2.0% seen in Q2. Looking at fundamentals, an inflated wage growth figure seen last week and falling consumer prices are good news for British shoppers and sellers. If real incomes remain robust, then consumption and overall GDP growth may pick up. On the monetary front, the absence of domestically generated price growth advocates that there is little need for monetary tightening and uncertainty still looms over the economy due to Brexit outcome scenarios.

Asia

China's GDP Loses Momentum

The second largest economy in the world expanded at the slowest rate in the third quarter since the rock bottom of the 2008-09 global financial crises. The trade war theme has created an environment of uncertainty, while the Chinese government tries to curb the high degree of corporate debt and lessen the amount of pollution created from the industrial sector. There was an obvious struggle from the auto sector. In details, sales of vehicles were at 7.6% y/y growth in Q1, car sales growth slowed to -1.5% in Q2 and -4.1% in Q3. The auto segment is a huge sector both in China as well as globally and it is often seen as an indicator for consumer sentiment. The economy grew at a slower at 6.5% in Q3, from 6.7% in Q2.

The latest reading has increased the pressure on the government to deliver support as investors grow increasingly skeptical about capital outflows. This has seen the yuan lose its value significantly since the start of the year and the Shanghai stock exchange is trading at a 4-year low. Chinese officials also tried to enhance investors' morale as stock markets suffered sharp reductions this year. The CSI 300, which tracks the largest companies listed on the Shanghai and Shenzhen bourses, dropped 23% YTD.

The Japanese yen was near a 1-month high versus the greenback at the start of the week at 111.61. However, the high was short lived as US treasury yields rose. The safe haven yen is extremely sensitive to rising US debt costs as the Japanese economy is in a negative interest rate territory. It seems that interest rate differentials favor a stronger dollar. The yen lost 0.33% of its value to dollar in the last five trading days.

Kuwait

Kuwaiti Dinar

USD/KWD opened at 0.30330 on Sunday morning.

Rates – 21 October, 2018

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	High	Low	Close	Minimum	Maximum	Forward
EUR	1.1550	1.1621	1.1431	1.1513	1.1330	1.1720	1.1612
GBP	1.3097	1.3235	1.3009	1.3070	1.2890	1.3290	1.3139
JPY	112.17	112.72	111.61	112.54	110.80	114.20	111.67
CHF	0.9910	0.9977	0.9845	0.9963	0.9770	1.0120	0.9874