Weekly Money Market Report
07 July 2019

Global Manufacturing Sector Under Immense Pressure

>NBK Treasury
+965 22216603
tsd_list@nbk.com

Highlights

- Global manufacturing sectors contract.
- Dollar rallies on labor report.
- US and European PMIs disappoint.
- Free fall in major treasury yields across Europe.
- A new dovish ECB president.
- Frail economic data out of the UK.
- RBA cuts rate again, Aussie soars.

United States

Factory activities contracted across the globe in June after PMI indicators came in below the 50 threshold. A global manufacturing index produced by the IHS Markit and others fell to its lowest level in seven years at 49.4. Nations like the UK, China, South Korea, Mexico and Germany have witnessed their industrial sector contract. The EU manufacturing segment has also entered the negative terrain, while the US sector tumbled to a near 3-year low. Meanwhile, Japan's Tankan index for large manufacturers slipped to its lowest level since 2016, reflecting the slowdown in the key Asian export country. The picture is just as depressing in the single market, where the majority of manufacturers except for France reported dwindling output. It seems like negative effects caused from the trade war are spreading across most continents.

Moving to the bonds market, the free fall in major treasury yields across Europe was the focal attention in financial markets last week. The German 10-year bund yield hit another record low at -0.405%, falling below the ECB's deposit rate of -0.4%, while Italian government bond yields dropped to their lowest levels in at least a year. UK's 10-year gilt yield also plummeted to a low of 0.66%, below the BoE's policy rate of 0.75%. On the other hand, US treasury yields soared after the jobs report reached markets. Hence, the divergence between US and European yields facilitated the dollar's rally. The dollar index appreciated by 0.93% versus a basket of currencies last week.

Dollar Rallies on the Labor Report, Cut Still Expected
The US Nonfarm payroll continues to be the stellar of the economy, while other economic figures disappoint to the downside. The American economy created 224,000 jobs in the preceding month from an unsatisfactory 72,000 seen in May. In spite of the decent jobs added in June, job growth averaged 172,000 for the first half of the year compared to an average of 223,000 seen last year. On the salaries front, wages remained in a constant state of 3.1% y/y and way below the 10-year high of 3.4% seen at the start of the year. The unemployment rate edged higher by 0.1% to 3.7% versus expectations of 3.6%. The resilience of the jobs market has somewhat counterbalanced worries about the relative health of the US economy such as softening activity in the manufacturing and services sector and below-target inflation. The greenback rallied after the release of the labor report from 96.846 to a 2.5-week high of 97.443 and the 10-year Treasury note yield jumped around 8.4 basis points to 2.033%. Although, markets still expect the US Federal Reserve to deliver a cut of 0.25% in July.

US PMIs' Support the Case for a Weaker Growth Prospect
Data provided by the Institute of Supple Management (ISM) showed that US factory activity had stumbled to nearly a three-year low last month and was the third consecutive fall for the manufacturing segment. The index shed 0.4 points to 51.7 dragged down by inventories and prices paid, which are currently below the break even rate of 50. The inventories index fell to 49.1 from 50.1 and prices paid index fell to 47.9 from 53.2. Compared to a year ago, prices paid index was at 79.5.

Unlike some of the regional manufacturing PMIs, the ISM manufacturing index evaded a fall below its breakeven rate of 50. Nonetheless, it is evident from the economic statistics that the industry is in the center of a slump that is similar in severity to the previous downturn in 2015 and early 2016. The latest deceleration is prominent since the noticeable improvement in 2017 and early 2018. The downward trend in manufacturing is having some undesirable effects on other industries. For instance, industry data show that freight shipments were rising at a double-digit pace in the first half of 2018 but are now declining on a year-over-year basis.

Looking at tariffs, US President Donald Trump has suspended his tariff threats on China and Mexico. He agreed to hold more trade talks with China, rather than impose import taxes on $300 billion of Chinese products. He also delayed 25% duty on all imports from Mexico, which he threatened to impose in May. Yet those threats still loom and are forcing many manufacturers to rethink their supply chains. Last Wednesday, the President turned his attention towards Europe. He accused Europe of being a currency manipulator. Moreover, the US and the EU have been entangled in a disagreement over aircraft subsidizations to Airbus (EU) and Boeing (US) for some 15 years. Last week the US administration intensified pressure on Europe by threatening to impose tariffs on $4 billion of additional EU goods. It seems that the trade war rhetoric is still in play mode and may further pressure the manufacturing sector down the road.

As for the largest contributor to US GDP, the services industry cooled more than expected in June to its lowest level in nearly 2 years. The services index fell to 55.1 in June from 56.9 in May due to declines in new orders and employment. In regards to the sub-components, the new orders index declined to 55.8 from 58.6 and the employment index descended to 55.0 from 58.1. The sector employs more than 80% of the US workforce and is critical to the health of the economy. Even though the sector is still growing at a healthy rate, growth has tapered off this year. Tariffs have impacted manufacturers negatively and some of the weakness now appears to be spilling over into the service side of the economy. Consistency in weakening PMI data across sectors, below target inflation, slower global growth, inversion of the yield curve and a never ending trade war theme could pave the way for US monetary officials to lower the overnight interest rate. Federal funds futures contracts are indicating a 100% chance of a 25 basis point cut on July 31.

Europe

Britain's Economic Indicators Feeble Across the Board
For the past two readings the UK's manufacturing industry has been in a contractionary environment. The latest figure for the month of June revealed that the IHS Markit Manufacturing Index fell to 48, the frailest reading in more than 6 years. Across the sub-indices, there were sharp drops in output and new orders indices. Moreover, new export orders fell for the third month in a row. Business confidence also plummeted, falling to its third-lowest level since IHS Markit's records began. The manufacturing survey is in line with a quarterly poll released from the British Chambers of Commerce, which indicated that factory sales rose at the slowest pace in seven years between April and June. Despite the gloomy overall results, there was some hope in the PMI survey. Around 44% of firms projected higher output in one year's time, while only 14% expected a decrease.

As for the dominant sector in the UK, the services PMI almost entered into negative terrain as the figure declined from 51 to 50.2. The near-stagnation of the services sector last month is one of the poorest performances seen over the past decade and comes on the heels of steep declines in both manufacturing and construction. The composite index that encompasses the construction and manufacturing sectors fell

to 49.7 from 50.9, signaling a drop in overall private sector activity for the first time in nearly three years. Construction activity stumbled from 49.3 to 43.1, the frailest reading since 2009. The overall growth outlook implied by the PMIs is anemic due to the fact that there is a strong correlation between PMI and future growth prospects. According to IHS Market survey provider, the composite PMI seen in the second quarter points to a minus 0.1% quarterly contraction in GDP growth. GDP growth for the month of May came in at negative 0.4% m/m; hence a recession may just be around the corner. Weakening global growth, combined with acute uncertainty over Brexit, frail data out of the British economy and few signs of material inflationary pressure supports the case for the BoE to hold rates at their current levels.

In the FX sphere, the Sterling pound persists in a downward trajectory falling back towards the strong support level of 1.2500 and was the worst performer in the currencies market. The negative momentum witnessed in the pound was due to the most unsatisfactory run of data last week since 2011 and it marks a sharp turnaround after the UK economy expanded by 0.5% in Q1. The releases of the latest PMI surveys have indicated that the UK economy may have contracted in Q2 and fears of a no-deal Brexit outcome looming over the economy led the GBP to depreciate by 1.32% against the USD last week.

The euro followed the pounds route lower versus the USD in the past five trading session, undercut by growing expectations for a looser ECB policy. The appointment of Christine Lagarde to be the next ECB President has strengthened market expectations for a looser ECB policy. It helps to explain in part why the US dollar failed to weaken more in light of the dovish re-pricing of Fed policy expectations. The single currency lost 1.24% of its value to the dollar.

Asia

The Reserve Bank of Australia Delivers on its Promise

The central bank of Australia (RBA) last week lowered the cash rate by 0.25% as expected to a new record low of 1.00%. This followed a cut from 1.50% to 1.25% on June 4, which was the first cash rate move in almost three years. The last time the Bank dropped its cash rate in two successive months was in 2012, in response to global concerns and the European financial crisis. The rate cut was widely anticipated and therefore it explains why the AUD/USD rose by around 40 basis points after the cut was delivered. The RBA stated that the “easing of monetary conditions will support employment growth and provide greater confidence that inflation will be consistent with the medium-term target”. Furthermore, officials indicated they “will continue to monitor developments in the labor market closely and adjust monetary policy if needed to support sustainable growth in the economy”. The introduction of “if needed” proposes that the central bank is in no rush to deliver an additional cut unless the economic stance proves frailer than projected. Nonetheless, the door remains open for further easing and the sharp drop in the cash rate by -0.50% suggests greater growth fears.

Manufacturing Sector in China Shrinks

China’s manufacturing sector came under further pressure in June after the manufacturing indicators disappointed to the downside. The NBS PMI index has been in negative territory for the past two months at 49.4, while the Caixin PMI index contracted for the second time this year also coming in at 49.4. Any reading below the 50 threshold suggests shrinkage in the aforementioned sector. In its latest report, Caixin said manufacturing production declined for the first time in five months with businesses pointing at trade tensions for the weaker sentiment. New orders dropped for the first time since January and export demand also softened.

On the political front, trade talks between the two largest economies are scheduled to resume after the positive outcome seen at the G20 summit. This could support business sentiment to some extent; however there is still a lot of lingering uncertainty as the core issues that prompted the trade war rhetoric are far from resolved. Overall, the manufacturing sector that accounts to 30% of China’s GDP is contracting, the service sector is slightly slowing down, growth is relatively low compared to historical standards and resolving the trade dispute is nowhere to be seen. As such, policy makers in Beijing could further ease monetary and fiscal policies to support future growth to come.

Equities

All three major US equity indices soared to new record highs last week thanks to mounting expectations that the US central bank would take a more dovish turn as a raft of data provided more evidence of a slowing economy. In addition, the latest trade truce between the US and China also played a positive role. The Dow Jones and S&P 500 gained 2.28% and 2.24% respectively, in the past five trading sessions.

Commodities

Oil prices tumbled drastically in the previous week even as OPEC members extended the supply cuts by nine months until March 2020. It seems that the outlook for global economic growth outweighed supply cuts. The price of Brent crude oil was subdued immensely falling to $62.19, the lowest level since February 11. Over the course of the week, Brent crude was 6% in the red.

Kuwait

Kuwaiti Dinar at 0.30370

The USD/KWD opened at 0.30370 Sunday morning.

Rates – 07 July, 2019

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	High	Low	Close	Minimum	Maximum	Forward
EUR	1.1367	1.1371	1.1205	1.1223	1.1025	1.1325	1.1309
GBP	1.2699	1.2707	1.2479	1.2522	1.2325	1.2625	1.2580
JPY	108.46	108.63	107.52	108.45	106.45	110.55	107.74
CHF	0.9792	0.9931	0.9807	0.9915	0.9815	1.0110	0.9839

© Copyright Notice. The Weekly Money Market Report is a publication of the National Bank of Kuwait. No part of this publication may be reproduced or duplicated without the prior consent of NBK.

While every care has been taken in preparing this publication, National Bank of Kuwait accepts no liability whatsoever for any direct or consequential losses arising from its use. This report and other NBK research can be found in the “News & Insight” section of the National Bank of Kuwait's website. Please visit our website, www.nbk.com, for other bank publications. For further information please contact: NBK Treasury Group, Tel: (965) 2221 6603, Fax: (965) 2241 9720, Email: tsd_list@nbk.com