Treasury Group

Weekly Money Market Report

16 July 2017

Central Banks Comments and Tapering Expectations Continue to Dictate the Market

United States

Diminishing Optimism in Yellen's Tone

The major event last week was Yellen's semiannual congressional testimony, wherein markets perceived her tone as less optimistic compared to the previous testimony. Yellen acknowledged recent improvements in the economy, highlighting the strength of the job market and claiming the economy is healthy enough to withstand a rate hike and a slow tapering of its balance sheet remain. Meanwhile, in the second day of her testimony, Yellen stated that the Federal Reserve was in no rush to tighten monetary conditions given the depressed path of inflation.

Looking at other Fed officials, Philadelphia President Harker noted "the recent slowing path of US inflation gives him pause over whether the Fed should raise rates for a third time this year." Moreover, two Fed members concluded that the federal funds rate isn't too far from the neutral stance. If that is the case, the central bank may be near the limit in terms of rate hikes. Global equities rose and the majority of bond yields around the globe fell after Yellen's second day of testimony.

The highly anticipated rate hike by Canada's central bank makes it the first major central bank to follow the footsteps of the Federal Reserve in tightening monetary policy in the wake of the 2007-2009 financial crisis. The BoC increased its overnight lending rate by 25 basis points to 0.75%, boosting the Canadian dollar to the highest since June 2016 versus the US dollar.

Canada's growth era is experiencing the strongest expansion shoot since the 2008-2009 recession, with the pace of expansion above 3% over the past four quarters. That's the fastest among Group of Seven countries and double what the central bank considers Canada's capacity to grow without fueling inflation. The BoC anticipates real GDP growth will moderate in the coming years from 2.8% in 2017 to 2.0% in 2018 and 1.6% in 2019. In regards to future monetary policy prospects, the bank signaled it did not want to commit to a predetermined path of more hikes until guided by incoming data as they inform the Bank's inflation outlook.

On the currency front, the greenback continued its downward trend last week and eased on Wednesday to a low of 95.464 in the aftermath of Yellen's testimony in front of Congress, which was perceived by the markets as dovish. The currency then continued it's decent to a 10-months low of 95.04 as inflation and retail sales data disappointed, raising concerns about the strength of the US economy and lessening the outlook of the Federal Reserve adopting a faster pace of rate hikes. The DXY opened the week at 96.00 and closed on Friday's session at 95.728.

The single currency began its upward momentum on Tuesday due to the weakness of the dollar. The EUR/USD grasped a 14-month high on Wednesday at 1.1489. After that rise, the pair lost its bullish flow as political concerns in the US increased the demand for euro zone government bonds pushing yields lower and investors taking their profits on long euro positions. The pair started its weekly session at 1.1400 and closed the week at 1.1467.

The GBP/USD was on the downside last week as BoE's deputy governor Ben Broadbent stated that he is not in favor of an early rate hike pushing the currency lower from $1.29 to 1.2846 its lowest level in July. The decline in the currency pair did not last for long, following the release of an employment report that was positive for the most part. The pound found more strength and managed to close the week on a positive note amid hawkish comments from BoE policy member McCafferty. Macafferty stated that the BoE should consider unwinding its GBP435 billion quantitative easing program. The GBP/USD began its weekly session at 1.2887 and ended on Friday at 1.3095.

The safe haven Japanese yen has depreciated nearly 5% over the past month against the USD as the diverging trend among a hawkish Fed and a dovish Bank of Japan widened. The yen recovered some of its losses last week after the greenback weakened. The USD/JPY opened on Monday at 114.00 and remained on a downward path until closing on Friday at 112.50.

In the commodities complex, gold found support last week following Yellen's less optimistic remarks and political uncertainty in the US. The precious metal appreciated from $1,207 on Tuesday to a five day high of $1,225.60. The price of gold per ounce on Friday's close was $1228.58.

US Job Openings Eases from Record High

The number of available job openings in the US economy descended sharply by 5% in May to 5.7 million as employers retained employees from the labor market reached the highest level since March 2004. Furthermore, the number of Americans who voluntarily quit their jobs increased by 7.1% to 3.2 million, suggesting strong confidence in the labor market.

Despite the labor market near the wall of full employment and the unemployment rate at 4.4%, wage growth has remained frustratingly sluggish. When unemployment is this low, wages generally rise. However, average hourly earnings have increased just 2.5% over the past 12 months. The last time the unemployment rate was this low, wages were rising by about 4%. A separate survey by an influential lobbying group for American small businesses showed that finding qualified workers is still one of their biggest worries.

Price Growth May Take Longer than Anticipated to Reach the 2% Target

Both producer inflation and core PPI slightly notched upwards by 0.1% for the month of June. The minimal uptick in monthly headline inflation was enhanced by prices for services gaining 0.2%, which accounts for almost 80 percent of the increase in the PPI. Although, inflation on both fronts are down from the previous year. Wholesale inflation year on year is down from May's reading of 2.4% to 2% and core data is down from 2.1% to 2%, providing further evidence of cooling inflation.

The cost for goods and services paid by Americans was flat during the month of June, while markets anticipated a rise of 0.1%. Last month, gasoline costs continued to decline downward by 2.6%, after dropping 6.4% in May. On an annual basis, consumer inflation increased 1.6%, slower than the 1.9% reading registered in May and down from five-year high of 2.7% just five months ago. Core inflation edged up by 0.1% in June and was unchanged at 1.7% over the past 12 months. The lack of a rebound in prices for goods and services could trouble Fed officials who have largely viewed the recent moderation in price pressures as transitory.

Europe & UK

Further Evidence of Robust European Economy

Industrial production in Europe's single economy accelerated at a monthly rate of 1.3% in May. The growth in the industrial sector is mainly due to production of capital goods rising by 2.3%, durable consumer goods by 1.8% and non-durable consumer goods by 1.2%. The countries that attributed the most to the sector were Lithuania, Romania and the Czech Republic. On an annual basis, industrial sector grew 5% in May.

The Eurozone Manufacturing PMI boomed to a 74-month high in June, reflecting the strongest trend for the sector in more than six years. At current levels, the PMI reading suggests for factory output to expand at an annual rate of around 5%. In the wake of upbeat numbers generally for the Eurozone in recent months, it's likely that May's hard data on industrial activity will provide further support to Europe's booming economic activity.

Eurozone Price Growth Remains Well Below the Target

ECB members hoping for hints of a steady rise in inflationary pressures to back their recent hawkishness encountered mixed signals from Europe's two largest economies. On a yearly measurement, the German consumer inflation edged slightly higher by 0.1% to 1.5%, while France's fell by 0.1% to 0.8% in June. The German CPI rose 0.2%, while French consumer prices remained flat for the month.

Eurozone inflation level remains well below the ECB's target of 2% and energy prices have been descending for four consecutive months. Subdued inflation may prolong the ECB's loose monetary policy, in a period of robust economic data out of the single economy.

Real Wages Turns Negative

Britain's unemployment rate in the three months through May eased further by 0.1% to 4.5%, the lowest rate in 42 years and the employment rate is at a record high of 74.9%. Annual earnings growth in May was up 2% compared with a 1.8% recorded in April. Taking into account for inflation, real wages fell for the third consecutive month and turned negative for the first time in over two years, increasing the probability of a slowdown in consumer spending.

The depreciation in consumers' confidence is likely to make workers even less willing to find new jobs, therefore decreasing the pressure on employers to offer higher salaries to retain staff. Even after the pick-up in regular pay, living standards are being diminished. Prices are gaining more momentum than wages and that is translating into weaker consumer spending. Perhaps not too far away, this might lead to higher unemployment and lower inflation.

Asia

China's Inflation Remains Subdued

Consumer price growth on yearly basis was unchanged in June and came in at 1.5%, slightly below the expectations of a 1.6% increase. Food prices, the largest component of the consumer price index, deflated at a 1.2% from the previous year, after sliding 1.6% in May and 3.5% in April. Weak price growth indicates subdued consumer demand and may trigger a slower pace of inflation period as consumers delay purchases of major items in anticipation that prices will continue to deteriorate.

On the producer front, inflation also remained constant in June at 5.5% from a year earlier, but well below the 7.8% reading four months earlier, that increasingly looks like a peak. The recent weakness in inflation is the oversupply in the steel industry and signs of economic weakness weighed on the outlook for prices. Moreover, activities in property and construction sectors remain soft, while commodity prices are on a downward trend suggesting the prospects of higher inflation are unlikely to occur in the second half of the year. As inflation loses momentum, central banks who are hoping for higher inflation globally may be disappointed.

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The Japanese Government Downgrades the Outlook for Orders

Japans core machinery orders an indicator of capital spending in the coming six to nine months fell sharply in May, while markets were expecting an increase. Core orders for machinery tumbled 3.6% month on month, marking the sharpest fall since August. The subdued data is related to the persistent weakness in the services sector that dropped 5.1%, and has been on the decline for three consecutive months. Compared with a year earlier, core orders grew 0.6% in May, versus the 7.7% growth expected by economists.

On the other hand, machinery orders are known to be volatile and a better indicator would be the BoJ tankan, which showed that large firms plan to raise their capital spending by 8.0% in the current fiscal year to March 2018. Moreover, confidence among Japan's largest manufacturers surged to its highest level in more than three years in the second quarter of 2017. Shortly after the release of core machinery data, BoJ's Governor Haruhiko Kuroda restated that the central bank will maintain its loose monetary program until inflation is stably above 2%.

Divergence among Business and Consumer Confidence

Business conditions in Australia surged to pre-global financial crisis coming at 15.1, according to a survey by the National Bank of Australia. Most industries performed well with stronger sales and better profitability. On the other side of the lever, employment conditions did not improve. Even though economic growth is expected to accelerate in the second half of 2017, the longer-term outlook could still underperform the RBA's upbeat expectations as important growth drivers like exports and commodity prices begin to fade.

However, the main issue is the divergence between business and consumer confidence over the past year. Elevated growth in profitability and weak wages growth indicates that the profits share of GDP has increased sharply to 20.4%, while wages share has fallen to 51.5%, the low seen in 2009. The data suggest that the rise in business confidence may not be sustainable.

Kuwait

Kuwaiti Dinar at 0.30280

The USDKWD opened at 0.30280 on Sunday morning.

Rates – 16rd July, 2016

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.1390	1.1.1390	1.1489	1.1467	1.1380	1.1650	1.1525
GBP	1.2882	1.2808	1.3113	1.3095	1.3000	1.3270	1.3145
JPY	113.96	112.24	114.49	112.50	110.50	113.40	112.06
CHF	0.9634	0.9601	0.9700	0.9633	0.9415	0.9700	0.9578