Weekly Money Market Report

5 August 2018

Major Central Banks Adopt Tighter Monetary Policy, Except BOJ

United States

Global markets seem to believe that the Federal Reserve is all set for a hike the next time it meets in September. What is not certain however, is the much talked about 4th hike in December. In order to reach that decision, US policymakers will be monitoring economic activity during the second half of the year, including potential fallout from trade-war escalation, the evolution of financial conditions, and possibly even political developments related to the midterm elections. Currently, market expectations of a December hike stand at 60%.

While highlighting the strength of America's economic expansion alongside inflation that is hovering close to its 2% target, the Fed kept interest rates unchanged last week in a move that was widely expected. The core PCE (personal consumption expenditure), widely known as the Fed's favorite inflation measure, came in at 1.9% for the third consecutive month last week. Furthermore, the US central bank signaled its intention to stay on course for a September hike, continuing its migration away from crisis-era stimulus that was enacted during the great recession.

Meanwhile, the dollar posted solid gains as it found support throughout the week. Expectations of a September hike were bolstered by the Federal Reserve, uncertainty caused by an escalating U.S.-China trade conflict, and Brexit turbulence were all factors that led to a stronger dollar. The dollar has now risen 8% from its lowest point of the year in February. At the end of the week, the dollar index rested at 95.143.

Labor data supports September hike

The US economy underwent its slowest pace of hiring in four months as job growth slowed more than expected in July. Nevertheless, should the Fed need more ammunition to justify a September hike, they can now point to a lower unemployment figure of 3.9%. According to the Bureau of Labor Statistics, the unemployment rate fell one-tenth of a percentage point (from 4% to 3.9%) in July, even as more people entered the labor force in a sign of confidence in their job prospects. The data still paints a fairly robust picture of the domestic labor market, which the Federal Reserve this week pointed to as part of the continued strengthening of the US economy and a key factor in why it is likely to continue raising interest rates this year.

US crude stockpiles light up oil volatility

Oil prices experienced some relief towards the end of the week after being pressured down. Throughout the week, oil prices suffered as a result of a surprise increase in US crude inventories. Moreover, the Trump administration added fuel to fire as it proposed a higher 25 percent tariff on $200 billion worth of Chinese imports. Nonetheless, oil prices rebounded from a six-week low after fresh reports of a decline in US crude as well as ongoing uncertainty linked to Iranian oil. Finally, Brent crude prices closed the week at $73.21.

UK & Europe

BOE announces hike in unanimous vote

After preparing the market for a hike announcement, the Bank of England went ahead with its second interest rate hike since the great recession. The central bank boarded the train along with other major central banks (except BOJ), with an intent to shift direction after years of stimulus-era policies. BOE governor, Mark Carney, said during the press conference that the central bank's interest rate cut two years ago, following the Brexit vote, had worked but now was the time to focus on taming inflation rather than supporting jobs growth. Carney justified the decision further, saying "employment is at a record high, there is very limited spare capacity, real wages are picking up and external price pressures are declining."

Decision to hike faces skepticism

Nonetheless, even though the vote in favor of a hike was unanimous amongst policy-makers, the decision was met with skepticism by some economists. They called into question the timing of the hike, and whether it was appropriate in a time where a global trade war is picking up steam. More notably however, is that Brexit day (March '19) is now less than eight months away and its impending circumstances are far from clear. The argument opposing the BOE decision claims there is no compelling reason to increase the cost of borrowing in the UK, but there is definitely good cause to wait.

Brexit troubles resurface

Speaking of Brexit, negotiations between the United Kingdom and the European Union hit another roadblock last week. BOE governor Carney said there was an "uncomfortably high" risk of a no-deal Brexit. He also added that for the UK to crash out of the EU without a deal would be "highly undesirable" and both parties "should do all things they can to avoid it". Brexit trouble compounded with the fact that the BOE is not in a rush to announce its next hike sent the British pound below 1.30 as it flirted with a one-year low.

Asia

JGB yield frenzy

Meanwhile in Asia, Japanese government bond (JGB) yields performed their best impression of a roller coaster during the past two weeks. It all started when investors got wind of a Reuter's report hinting of a BOJ move towards tapering its monetary stimulus program in accordance with other major central banks. Consequently, nervous investors rushed to sell JGB's, sending yields rocketing. In a contagious manner, a wave of selling ensued across global bond markets, where Japanese investors have turned in recent years in an effort to escape the measly returns available domestically. Due to the pace JGB yields were rising at, the Bank of Japan intervened three times with a rare offer to buy unlimited amounts of 10-year notes after yields reached their highest level in 18 months.

BOJ defies expectations

Contrary to earlier reports however, the Japanese Central Bank defied expectations while making it clear it would not join the world's other major central banks in rolling back crisis-era stimulus policies. The bank also introduced forward guidance for policy rates for the first time, saying that the extremely low levels would remain "for an extended period of time". "This will fully counter speculation among some market participants that the bank is heading towards an early exit or an increase in rates," Haruhiko Kuroda, BoJ governor, said at a news conference in Tokyo.

In a spectacular fashion, JGB yields initially dropped 50% after the announcement and then proceeded to rise 160% in a matter of hours as market sentiment shifted. In the FX market, the yen witnessed its fair share of volatility as well, losing 0.35% of its value against the US dollar.

Kuwait

Kuwaiti Dinar

USD/KWD opened at 0.30295 on Sunday morning.

Rates – 5th August, 2018

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.1658	1.1558	1.1745	1.1567	1.1365	1.1660	1.1648
GBP	1.3093	1.2973	1.3172	1.3005	1.2800	1.3100	1.3058
JPY	111.03	110.76	112.14	111.25	109.25	112.20	110.55
CHF	0.9946	0.9866	0.9964	0.9941	0.9740	1.0140	0.9865