Treasury Group
Weekly Money Market Report
12 February 2017

Europe at a Crossroad

United States

Expectations versus Reality

Since the November election, analysts rushed to revise their growth estimates of the US economy higher with inflation rising modestly and the Fed raising rates a couple times this year.

Equity markets quickly discounted the potential introduction of a new major fiscal stimulus in the US and extended gains, while the upbeat tone from the industrial and manufacturing surveys have amplified these expectations driving a kind of euphoria in consumer and business sentiment.

When reality checks in and uncertainty about the fiscal policy outlook sets in, you will find a constrained Fed into a waiting mode to see what the Trump administration would announce. While the dot plot suggests three hikes in 2017, odds of a March rate increase still seem relatively low due to the lack of clarity from the new administration.

Although markets have been relatively quiet this week with no major macro releases and just a few headlines from public figures, conflicting views from US Fed presidents added more uncertainty in the market. Indeed, Minneapolis Fed President Neel Kashkari's indicated that he was in no rush to hike interest rates pointing out that monetary policy has been accommodative for several years without rapid tightening of job market, nor sudden surge in inflation. However, voting Fed President Patrick Harker said he would be open to raising interest rates again at the US central bank's March meeting if growth in jobs and wages continues. "I still am supportive of three rate hikes this year, of course with a major caveat, depending on how the economy and fiscal policy evolve," and “I think March should be considered as a potential for another 25-basis point increase."

The only notable headline that could be potentially market moving came from Donald Trump who promised a major tax announcement without adding further details during a White House meeting. "We're going to be announcing something I would say over the next two or three weeks that will be phenomenal in terms of tax and developing our aviation infrastructure," Trump said on Thursday.

In Europe, uncertainty was fueled further due to the increasing political instabilities. Bank of France Governor François Villeroy and ECB President Mario Draghi replied to Donald Trump’s advisor’s recent comments that the Euro was “grossly undervalued” and that Germany was a “currency manipulator” were “more than absurd.” Draghi also added that the EU’s monetary policies reflect the diverse positions in the economic cycle of the Eurozone and the United States.

On a different more sensitive European subject, recent polls have shown German Chancellor Angela Merkel falling behind a candidate from the country's Social Democrats in this year's elections while polls in France suggested far-right wing Marine Le Pen, who has advocated pulling the country out of the European Union, is gaining ground after controversy struck leading opponent François Fillon.
The effect of these developments can be seen in the bond market and the Euro price movements where French bond yields climbed near to a 17-month high as fears of a gaining Marine Le Pen rattled markets. In the US, renewed speculation that Trump's economic policies will help boost growth and inflation pushed US Treasury yields sharply higher on Thursday.

On the currency side, the Euro has been slowly declining by 1.27% over the week as investors preferred the safety and perceived bullishness of the US Dollar, closing the week at 1.0641. In return, the US dollar index made gains pushing it back above the 100.00 level to 100.65.

Against the JPY, the USD jumped higher on Thursday after Donald Trump finally commented on his stimulus measures, promising a "phenomenal" tax plan in the coming weeks. The greenback soared 1.5% against the yen as US Treasury yields rose sharply in the wake of Trump's comments. Treasury yields declined steadily until Thursday to multi-week lows, pushing the dollar to a 10-week low of 111.59 against the Yen. The USD/JPY closed off the week at a high of 113.22.

The Sterling Pound opened the week on a weak tone after disappointing PMI data last week but managed a short lived high Thursday as some more upbeat British housing data helping soothe nerves over domestic economic growth before comments by US President Trump on taxation sent the dollar broadly higher. The GBP opened the weak at 1.2491 and reached a high of 1.2582 to close the week lower at 1.2487.

US Deficit Lower, with a healthy Job Market

The US goods and services deficit was $44.3 billion in December, down $1.5 billion from $45.7 billion in November. December exports were $190.7 billion, $5.0 billion more than November exports. December imports were $235.0 billion, $3.6 billion more than November imports. The December decrease in the goods and services deficit reflected a decrease in the goods deficit of $1.2 billion to $65.7 billion and an increase in the services surplus of $0.3 billion to $21.4 billion. For 2016, the goods and services deficit increased $1.9 billion, or 0.4%, from 2015. Exports decreased $51.7 billion or 2.3% and imports decreased $49.9 billion or 1.8%.

On the employment front, according to the US Bureau of labor statistics, the number of job openings was little changed at 5.5 million on the last business day of December. Over the month, hires and quits were also little changed at 5.3 million and 5.0 million, respectively. The quits rate was little changed at 2.0% and the layoffs and discharges rate was unchanged at 1.1%.

Last but not least, the number of Americans seeking unemployment benefits dipped to a 12-week low at the start of February, a sign of a stabilizing job market. Claims for jobless aid fell 12,000 to a seasonally adjusted 234,000, the best reading since November, the Labor Department said Thursday. The less-volatile four-week average declined 3,750 to 244,250, which was the lowest average since November 1973.

Europe & UK

Draghi in a Wait and See mode

Mario Draghi offered nothing new in a testimony before the European parliament Monday. He stressed that the central bank remains ready to increase its asset purchases in size and duration, confirming at the same time the monthly purchase pace of €60 billion from April to December 2017. Furthermore, he reiterated that the recent uptick in inflation figures are largely due to higher energy prices, while underlying inflation pressures remain subdued. “So far underlying inflation pressures remain very subdued and are expected to pick up only gradually as we go on,” as stated.

Higher German Industrial Orders

German industrial orders went up 5.2% from a month earlier in December of 2016, following an upwardly revised 3.6% drop in November and beating market consensus for a 0.5% rise. It was the biggest increase since July 2014, driven by higher demand for capital goods. By contrast, demand declined for consumer and intermediate goods. Domestic demand rose by 6.7% and foreign orders increased by 3%, with bookings from Eurozone countries jumping by 10% while incoming orders from the rest of the world showed no growth.

No Sign of "Brexit" Stress until now

House prices in the three months to January were 2.4% higher than in the previous quarter; marginally down on 2.5% in December. The annual rate of growth eased to 5.7% from December’s 6.5%, and is well below last March’s peak of 10.0%. The quarterly and annual rates of house price growth remain robust even though they are lower than in spring 2016. UK house prices continue to be supported by an ongoing shortage of property for sale, low levels of housebuilding, and exceptionally low interest rates. These factors are unlikely to change materially during 2017. Nonetheless, weaker economic growth and increasing pressure on spending power, along with affordability constraints, are expected to dampen housing demand, resulting in some downward pressure on annual house price growth during the year.

On the industrial front, the UK industrial and manufacturing production data showed that the overall industrial activity extended its expansionary mode in December, surprising markets to the upside. Manufacturing output jumped 2.1% in December versus a revised 1.4% rise seen in the previous month, while total industrial output also showed a strong performance on monthly basis, with the figures showing a 1.1% growth in the reported month, against 0.2% expected and a 2.0% rebound seen in November.

Asia

RBA Rates Unchanged

The Reserve Bank of Australia has left its cash rate steady at 1.5% for the fifth consecutive board meeting as it prepares to release forecasts showing economic growth picking up and inflation climbing from 1.5% to more than 2%. In a statement after the board meeting, Governor Lowe's said growth would be boosted by further increases in resource exports and by the revival of mining investments. He continued, "Consumption growth is expected to pick up from recent outcomes, but to remain moderate. Some further pick-up in non-mining business investment is also expected."

China Trade Surplus Expands

China's trade surplus expanded faster than expected in January as Beijing posted a trade surplus of 355 billion yuan in January, up from 275 billion yuan in December, well above forecasts calling for 295 billion. It was the largest trade surplus since January 2016, mainly driven by a surge in exports while imports rose further as well. Exports increased at an annualized 15.9% while imports emerged out of a multi-year downtrend to post an annualized 16.7% jump. Analysts warn however, that trends in January and February can be distorted by the week-long Lunar New Year holidays, with business slowing down weeks ahead of time and companies scaling back operations.

China Services PMI Fall

The Caixin China Services PMI fell to 53.1 in January of 2017 from a 17-month high of 53.4 in December and below market consensus of 53.6. Output and new orders rose at slower paces while employment increased the most since May 2015 and business sentiment hit 18-month high. At the same time, the amount of unfinished work increased while the backlog accumulated marginally. Companies reported higher cost burdens, with the rate of inflation edging up to the fastest in 47 months. Also, producers went up their prices at a faster pace but remained marginal overall. Services PMI in China averaged 52.34 Index Points from 2012 until 2017 showing January's figure, while below market consensus, still solid in terms of growth.

Kuwait

Kuwaiti Dinar at 0.30520

The USDKWD opened at 0.30520 on Sunday morning.

Rates – 12 February, 2017

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.0784	1.0606	1.0787	1.0638	1.0455	1.0830	1.0687
GBP	1.2473	1.2344	1.2582	1.2489	1.2295	1.2675	1.2524
JPY	112.62	111.57	113.85	113.19	111.55	114.85	112.82
CHF	0.9925	0.9896	1.0062	1.0020	0.9855	1.0185	0.9980