Treasury Group

Weekly Money Market Report

02 July 2017

A Turning Point for Europe

United States

The End of the Dollar Bull Run

The second half of 2017 seems to be taking the shape of nonconsensual Fed members views over the current state of the US economy. Whether St. Louis Fed Bullard reiterating his views that “the current level of the policy rate was appropriate given the current macroeconomic environment, some Fed members have started doubting the idea that U.S. inflation is reliably returning toward the set target. Over the size of the Fed balance sheet, there at least seems to be a consensus to be prudent to announce a balance-sheet adjustment anytime soon and any decision is likely to be pushed toward the end of the summer.

With the market more and more unconvinced about a much higher terminal Fed Funds rate in the US and with a honeymoon period likely to continue in Europe, we are likely to witness a continuation of the US dollar meltdown in the second half of 2017, with a risk of higher lower yielding currencies that have been shunned in the past three years. Should market expectations about ECB tightening rise much further as they did this week, this would likely tighten financial conditions in the Euro area and push the currency higher against the Dollar.

More global central banks seem to be jumping on the tightening wagon by changing their view. Whether the Bank of Canada, the Bank of England and the ECB; all have helped weakening the US dollar by sending the Euro, Canadian dollar and Pound higher this week.

On the foreign exchange side, the U.S. dollar index extended its recent losses almost day by day after recent prospects of monetary tightening emerging at both the European Central Bank and the Bank of England. The index lost 1.56% of it’s value during the week. The DXY depreciated to its weakest level since October 2016 on Thursday, falling to 95.50. The dollar was on course for its worst quarter in seven years on Friday, recovering only marginally against major peers. The index opened on Monday at 97.254 and ended its weekly session at 95.66.

Last week, the single currency began its upward momentum on Tuesday when ECB’s President Draghi presented an optimistic view of the Eurozone economy, and put a positive spin on inflation, stating that “deflationary forces have been replaced by reflationary ones.” Moreover, Draghi mentioned that the loose monetary policy was needed for now, but would be gradually withdrawn once inflation moved higher. The EUR/USD on Thursday was elevated to new highs for the year at 1.1445. The pair opened the week at 1.1196 and closed on Friday at 1.1427.

In terms of the British Pound, the GBP/USD started the week at 1.2739 and was in consolidation mode until Wednesday. The Sterling pound gained support on Wednesday by the head of the BoE Mark Carney who stated that that raising interest rates in the UK in the next few months could become more appropriate and tolerance for higher inflation from the MPC could soon start to disappear. At the end of the week, GBP/USD soared to 6 weeks high amid growing expectations that interest rates could soon rise, while political uncertainty following the election fades.

In Commodities, oil has delivered a 5% gain this week, with prices gaining support from government data that showed a drop off in US gasoline supplies, which have previously remained stubbornly high, leaving to a close firmly above $45.

Fed Voices Concerns about Assets Valuations Levels

Fed Chair Yellen didn't give any indications this week whether the current policy tightening has changed, saying “we’ve made very clear that we think it will be appropriate to the attainment of our goals to raise interest rates very gradually.” The caveat was when she said that asset valuations, by some measures, "look high, but there's no certainty about that".
In parallel, Fed Vice Chairman Fischer said that rising valuations in equities and other segments of the global market are partly explain by a brighter economic outlook, but also by elevated risk appetite. Fischer also warned against complacency. “So far, the evidently high risk appetite has not led to increased leverage across the financial system, but close monitoring is warranted.”

No Consensus over the Current state of the Economy

On the current state of the economy, San Francisco Fed President Williams said that “the US economy has regained, and even surpassed, full employment benchmarks. “Although our inflation rate is still somewhat below our 2% medium-term target, I and my colleagues on the Federal Open Market Committee expect us to reach that goal in the next year or so”.

On the lesser bright side, Philadelphia Fed President Harker also was on the wires, saying he thought the central bank may have to rethink its plans for hiking interest rates if US inflation continues to wane. "My forecast is for the ceasing of reinvestment of bond profits this year and possibly one more rate increase, but if we start to see inflation continue to deteriorate ... then I would revisit that. We have to be open to that."

With low inflation and wages showing little sign of an upward surge, Minneapolis Fed President Kashkari doesn't think the central bank should be in a hurry to lift interest rates. "Why are we trying to cool down the economy, when there may still be some slack in the job market, and there is still some room to run on the inflation front?" Kashkari said Tuesday. "We're not seeing wages climb very fast, and we're not seeing inflation. That tells me the economy is not on the verge of overheating

US Bleak Data

The US consumer confidence index rose to 118.9 in June, up from 117.6 previously while estimates were for 116. The improvement was driven by the present situation component, which increased to 146.3 from 140.6, while the expectations index declined to 100.6 from 102.3 last month.
The Richmond Fed manufacturing index also rose to 7 in June, up from 1 in May and above the consensus estimate for 5. Looking at the details, the subcomponents for shipments and new orders increased. Employment was relatively flat
On the brighter side, US first quarter GDP was revised up to a 1.4% while consensus was for a 1.2%. This is twice the growth rate of the original print for the first quarter, which came in at 0.7%. There were revisions throughout the report but the biggest change was in consumption, which was revised up to 1.1% from 0.6%. Investment was lower from 4.8% to 3.7%, mostly reflecting business spending.

Europe & UK

Changing Tone at the ECB

This week, ECB President Draghi decided to rock the boat saying that “the global recovery is firming and broadening” and that a “key issue facing policymakers is ensuring that this nascent growth becomes sustainable”. However, he said that “inflation dynamics remain more muted than one would expect", citing external price shocks and more slack in the labor market. Draghi thinks that these effects are only temporary in nature and “should not cause inflation to deviate from its trend over the medium term”.

In parallel, ECB Governing Council member Jens Weidmann was more upbeat saying that “citizens must be able to rely on the Governing Council to expeditiously end its expansive monetary policy if it is necessary from the point of view of price stability”.
We have to make it clear that we are guided by monetary policy considerations alone and that the finance ministers have to cope with rising financing costs of public budgets” when ECB exits its “very loose monetary policy.”
He added that the ECB council hasn’t discussed a possible extension of the bond-buying program and that the ECB should look at the “exit from the very loose monetary policy” if economic growth and inflation develop as expected.

Europe’s Manufacturing on Fire

French real GDP grew more than expected in the first quarter and rose 0.5%, up from 0.4% previously and above estimates for 0.4%. With this figures, the expected growth of 1.5% for the whole of 2017 would be the strongest since 2011.
Moreover, the preliminary manufacturing PMI also surprised to the upside and rose to 55 in June, while the services PMI declined to 55.3, down from 57.2. Nonetheless, the PMI data suggests that the French economy continues its recovery. A breakdown showed that firms expanded their payrolls the most since August 2008.

In Germany, the preliminary manufacturing PMI declined less than expected to 59.3 in June, down from 59.5 in May whereas consensus was for 59. Strong demand from Europe, America and Asia translated into growth in new orders for the sixth time in seven months. New orders grew at the fastest pace since March 2011.
Moreover, the services PMI declined more than expected to 53.7, down from 55.4 and below the consensus estimate for 55.4.

Raising Rates at the Worst time?

According to Bank of England Governor Carney, the MPC may need to begin raising interest rates in the coming months. “Some removal of monetary stimulus is likely to become necessary if the trade-off facing the MPC continues to lessen and the policy decision accordingly becomes more conventional.”
To reiterate the point, BoE’s Chief Economist Andrew Haldane said that "we need to look seriously at the possibility of raising interest rates to keep the lid on those cost of living increases. For now we are happy with where the rates are, we need to be vigilant for what happens next." He noted that weak pay growth has repeatedly surprised the BoE. He added that policy makers are watching for signs of a pickup in wages and that weak productivity is helping to suppress pay. He reiterated that any policy tightening will be limited and gradual.
On the economic data side, the GfK consumer confidence index fell to -10 in June, lower than the consensus estimate of -7 and down from -5 in May. It was the lowest reading since last July's -12 shortly after the UK's EU referendum. According to the report, "strong consumer spending has propped up the economy since last June, but now the twin pressures of higher prices and sluggish wage growth are squeezing household finance and adding to widespread fears of a Brexit-induced economic slowdown.

Asia

Deleveraging will Pose Risks

China’s June manufacturing PMI came in at 51.7 for June, above both the previous month at 51.2 and expectations of a 51. This was the second highest level of 2017, on the back of improving market sentiment and industrial upgrading, according to the report. Both inflation indicators were higher, as the input prices index rose to 50.4 from 49.5 in May, and the output price index rebounded to 49.1 from 47.6 in May after three consecutive months of decline. Both new export order index and the import index increased by more than one point reaching 52.0 and 51.2 respectively.

As a whole, the economic activity this year has proven to be more resilient than expected, giving policymakers’ time to focus on cutting back on financial risks and cooling a bubble in the property sector. This week, the release of China's Beige Book showed the economy improving in the second quarter, but moving forward, the report tackle the deleveraging which is likely to pose risks on the performance of the economy in the second half of the year. According to the article, while leaders have pledged to cut back on excessive leverage, business activity remains resilient because companies assume curbs will prove transient.

It is crucial to maintain accommodative financial conditions

In the BoJ's minutes for its June meeting, several policymakers called for the central bank's monetary policy stimulus to be maintained, with some members noting that achievement of the 2% inflation target will take some time.
"The price stability target cannot be achieved easily within a short time-frame. It is crucial to maintain accommodative financial conditions and keep the economy expanding as long as possible," one board member said. Policymakers also focused on how best to communicate their intentions to the market, as an improving economy draws more attention to the timing of an exit from easy monetary policy. "As the economy continues to improve, the BOJ needs to be accountable for its thinking on monetary policy to avoid raising concern among market participants," one board member said. The minutes also stated that “an increase in wages has been observed and private consumption has increased its resilience.”

Kuwait

Kuwaiti Dinar at *0.30300*

The USDKWD opened at 0.30300 on Sunday morning.

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Rates – 02 July, 2017

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.1199	1.1170	1.1445	1.1427	1.1315	1.1580	1.1483
GBP	1.2728	1.2703	1.3030	1.3031	1.2900	1.3180	1.3069
JPY	111.10	111.10	112.92	112.41	111.30	114.20	111.96
CHF	0.9691	0.9550	0.9737	0.9585	0.9410	0.9675	0.9469