Weekly Money Market Report

2 December 2018

May's Brexit Deal

UK & Europe

After the terms of Theresa May's Brexit deal got signed off at the European council meeting on Sunday, the British prime minister is now facing the struggle to win the House of Commons in order to kick off her plan. May has embarked on a two-week campaign to sell the historic deal, telling MP's that they risk taking the country into "more division and uncertainty" if they reject the deal. The aim of the deal is to deliver a smooth divorce, ending Britain's 45-year association with the European project. Mrs May had agreed with the European Commission president and the European Council president that both sides are to insist the deal was the only option on the table with no plan B, either it or a no-deal Brexit.

The vote will take place on the 11th of December, where the Parliament will cast its vote on the 585 page deal that the EU agreed on of which commitments run to 2030 and beyond.

The first area of agreement is the divorce bill, a financial settlement that the UK will pay to the European Union to honor its financial commitments to Brussels. The commitments consist of two aspects, UK's contribution to the EU's budget which will last till the year 2020, and payments to EU projects that the UK had already agreed to. The way that the divorce bill works is not all of the payments are due immediately. In fact, the UK will still be paying the EU in 2064. According to the Office of Budget Responsibility, about 45% will be paid in the first two years, then another 48% will be paid by 2028, the final 7% will be paid between 2029 and 2064 and will be covering all of the last financial commitments such as paying towards the pension of EU staff. Using conservative assumptions, the UK Treasury is expecting a net British outlay of EUR 40bn to EUR 45bn.

Next is the agreement on citizen rights, which maintains the existing EU residence and social security rights of more than 3mn EU citizens in the UK, and around 1mn UK nationals living on the European continent. EU citizens will be allowed to move to the UK until the end of the transition period currently set for 2020, they will be allowed to live and work in the UK and if they stay for five consecutive years, they will be allowed to stay in the UK permanently. The same is true for UK citizens living in the EU.

Perhaps one of the hardest issues that needed to be dealt with is the Irish border issue. The 496km border between Northern Ireland and Ireland has been completely open for twenty years since the signing of the Good Friday agreement brought peace to the border. Currently there are no hard crossing points on the borders, and the Brexit issue brings difficulties as both the EU and the UK will have the need to impose their own customs regulations and tariffs, a goal not easily achieved with an open border. The deal assumes a comprehensive free trade agreement to be signed between the EU and the UK between March 29th next year, when the UK actually leaves the EU, and the end of the transition phase at the end of 2020. This means that the free trade agreement does not need to come into force until January 2021.

During the transition phase, the UK will continue to follow EU rules and customs regulations, meaning that while we are in the transition phase the border can stay open. As reaching a free trade agreement is not an easy task, the EU insisted on having a backstop in place. The backstop means that the whole of the UK stays in the EU's customs union; unless and until the EU agrees that the UK leaving won't result in a hard border, essentially continuing the transition period indefinitely. During which Britain would leave the political institutions of the EU, losing its say over rules and decisions but continuing to apply by the EU law. This clause is one of the terms that are creating a lot of resistance to May's deal.

The Bank of England published its economic analysis of the deal, comparing it with the cost of a disorderly "no-deal" exit. Government economists had calculated that if May's deal comes forward, Britain would be 3.9% worse off in 15 years' time than if it had remained in the EU. While this does not sound like a good outcome, the BoE warned that in a cliff-edge Brexit where the UK crashes out of the EU with no deal and no transition, could lead to the sharpest drop in national income since the Second World War. GDP could fall as much as 10.5% over a 5 year period, compared to pre-referendum levels, and house prices could plummet 30%. This compares to a respective drop of 6.25% and 17% during the financial crisis.
This has lead PM May to insist that the analysis shows UK will be "better off" under her Brexit deal, as she embarks on her campaign to collect votes to support her case.

President Donald Trump has commented on May's deal saying it would benefit the EU while damaging the UK's ability to trade with the US. Trump's comments will add to the pressure on the prime minister as she attempts to win converts within the Parliament.

The Sterling pound did not bode well in light of the tensions surrounding the subject, showing that investors do not believe that a vote to back the deal is going to happen. The pound did get a short breath of air amid the BoE Brexit report, but it quickly took a downturn as the prime minister did not rule out the possibility of a no-deal Brexit during a meeting of the commons liaison committee. The Cable closed the week 0.77% down at 1.2751.

United States

Federal Reserve Chairman Hints Towards Rate Hike Easing

The US Federal Reserve is expected to go forward with further gradual hikes in interest rates if the US economy stays on track. Almost all policymakers had agreed on the plan as indicated in the latest minutes, with a further quarter point rise expected at the upcoming meeting on December 19. The current Federal Fund rate is at 2-2.5%. Federal Reserve chairman Jerome Powell declared US interest rates are closing in on "neutral levels", sparking the best day for equity markets since March as investors interpreted a slowdown in the rate-rising program. Given that rates are hovering "just below" estimates of neutral, the Fed chair explained that there is "no present policy path" and that the central bank "will be paying very close attention to what incoming economic and financial data are telling us."

The comments made in New York on Wednesday came as the central bank faced increasing pressure from President Donald Trump, to hold back from further rate rises. Trump told the Washington Post that the Fed is "way off base with what they're doing", adding "so far, I am not even a little bit happy with my selection of Jay." During Powell's speech, no direct mention of Trump's criticisms was made. He did however claim that the Fed had been right to embark on gradual rate rises given that the economy was no longer benefiting from the low rates sparked by the 2008 financial crisis. The S&P 500 experienced its best day in eight months, closing 2.3% higher following the speech. The Dow Jones Industrial Average and the Nasdaq Composite followed the same trend, closing 2.5% and 2.9% higher respectively. The US dollar weakened, dropping 0.85% following the comments, and closed the market at 96.778.

Asia

Japan's Manufacturing Slowdown

The growth in Japan's manufacturing sector slowed to a two-year low during November, according to a preliminary reading. The flash manufacturing purchasing managers index of Nikkei-Market fell to 51.8 this month, reaching its lowest reading since November 2016. The reading is down from the 52.9 recorded in October. According to the survey, manufacturers reported weaker demand for the first time since September 2016 with new orders decreasing.

Commodities

Looking at commodities, oil prices have tumbled around 30 % after hitting a four-year high in early October. US sanctions against Iranian supply coupled with supply losses in Venezuela and an uncertain global political environment has weighed heavy on the oil market. With continuous pressure from US President Donald Trump to increase production, the expected slowdown in oil demand growth has gutted Brent prices. The outcome of the OPEC meeting scheduled next week in Vienna remains unclear as both Russia and Saudi Arabia have revealed a willingness to cut output in an attempt to counteract the issue of oversupply. Brent crude is currently hovering around the 57.55 level, while the West Texas Intermediate is down to 50.73 from a high of 76.40 in October.

Kuwait

Kuwaiti Dinar at 0.30400

The USDKWD opened at .30400 on Sunday.

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.1370	1.1305	1.1372	1.1315	1.1115	1.1520	1.1410
GBP	1.2753	1.2736	1.2779	1.2751	1.2550	1.2955	1.2820
JPY	113.48	113.45	113.70	113.46	111.45	115.50	112.553
CHF	0.9979	0.9976	1.0004	0.9987	0.9775	1.0190	0.9893