Weekly Money Market Report
04 August 2019

A Hawkish Interest Rate Cut by the FED

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Highlights

- Trump imposes further tariffs on China.
- Safe haven assets in demand.
- FED cuts overnight rate as expected.
- US labor market remains resilient despite slowdown.
- Positive data nowhere to be seen in the euro-zone.
- Bank of England's future path uncertain.

United States

Risk Aversion Reemerges in Financial Markets

The risk aversion theme is back in play mode and the truce between the two largest economies at the G20 summit has dissipated. President Trump sent commodity currencies and stock markets worldwide into the red-zone by hitting China with an additional 10% tariffs on $300 billion in Chinese imports starting on September 1. Beyond the sell-off in risky assets, there are a number of significant consequences to Trump's announcement. Most importantly, the probability for further loosening of monetary conditions by central banks including the FED increased exponentially with the new tariffs. Markets were pricing in a 50% chance for a cut of 25 basis points in September by the FED after last week's hawkish FOMC meeting. That all changed as the tariffs threat emerged and drove up the probability of a cut to 100%.

The greatest distress to the global economy has been trade tensions and now the tensions have materialized significantly. China may have to inject further stimulus to avert a larger slowdown in their economy and as a result, the USD/CNY could breach the 7 level. Hence, this could place downward pressure on currencies all over Asia and destabilize their growth. More losses may take place for equities and other risky assets as markets bet that the FED is no longer one and done after Trump's announcement.

Looking at safe haven assets, the Japanese yen, Swiss franc, gold and U.S. government bonds witnessed robust demand as investors rushed towards safety. Gold gained 1.44% from last week's low and the yen soared around 2% in one day after the tariffs announcement. The 10-year treasury yield dropped around 21 basis points in the past five trading sessions as bond demand intensified.

On the monetary policy front, the U.S. central bank lowered its overnight interest rate by 25 basis points to a range of 2-2.25% for the first time since the Great Financial Crisis and ended its balance sheet reduction two months in advance. Surprisingly, the U.S. dollar appreciated tremendously even though rate cuts are seen as fundamentally negative for a currency. It seems that financial markets interrupted the FED's move as a hawkish cut for the following reasons. FED Chairman Powell made it clear that "it's not the beginning of a long series of rate cuts." At the same time, he said, "I didn't say it's just one rate cut." Looking at the votes, two FOMC members voted against a rate cut. Most importantly markets had already fully priced in a 25 basis points rate cut, with some traders looking for a more aggressive 50 basis points move.

Powell also portrayed a resilient picture for the economy by focus on the strength of the labor market, the recent uptick in retail sales and the general resilience in the economy. The rate cut was aimed at enhancing price growth and protecting against downside risks caused by the trade war theme. Overall, the 25 basis points cut may not be the last one for the FED and the Bank doesn't see a reason for an immediate follow up action. Considering that Powell sees nothing in the U.S. economy poses a major short term risk, he's telling us that there might not be a need for another rate cut this year. However, markets implied probability for a 25 basis points cut by year end was around 80% after the monetary announcement. The U.S. dollar index appreciated to more than a two-year high of 98.932 as the FED proved to be one of the least dovish central banks.

In the FX sphere, the dollar index performance over the past month has been exceptional gaining 2.35% in July against a basket of currencies. On the last trading day of the month, the dollar index soared to a 26-month high of 98.932 after the FED's tone appeared to be less dovish than markets' had previously predicted. As a result of Powell's tone, the probability of a September rate cut dropped from over 80% to close to 50%. The possibility for further monetary stimulus worldwide, greater likelihood of a No Deal Brexit and better than expected U.S. Q2 GDP have paved the way for a dollar rally. The dollar remains supported by interest rate differentials even as the FED lowered its overnight rate, U.S. rates will remain well above most G10 peers.

U.S. Labor Market Cools Down Slightly in July
The American economy added 164,000 jobs last month from the prior reading of 224,000. The data for May and June were revised lower by 41,000. Employment has decelerated this year to an average monthly pace of about 170,000 from 223,000 in 2018, but that's still a solid performance. Wages surprised to the upside rising from 3.1% to 3.2% in annual terms and the unemployment rate remained constant at 3.7%. Overall, July's numbers indicate that the labor market is maintaining its energy during a record-long hiring streak.

Optimism in U.S. Consumers
American consumer optimism sky rocketed last month, recuperating from a trade war fear seen in June. Consumers grew far more confident as trade talks had restarted, the outlook for jobs remains resilient and U.S. equities posted decent gains in July. The confidence index jumped to 135.7 the highest level since late 2018, from 124.3 recorded in June. The robust confidence could support spending in the near-future, which accounts to around 70% of U.S. GDP. The government mentioned that consumer spending rose at a 4.3% annual rate from April through June, the fastest pace since the end of 2017. If optimism lingers on and consumers remain in spending mode this may help offset the weaknesses seen in the manufacturing sector this year.

Europe

Positive Data Nowhere to be Seen in the Euro-Zone
Encouraging economic figures out of the single economy are nowhere to be seen and the persistency in frail data bolsters the likelihood for a rate cut in September by the ECB alongside with a new round of quantitative easing. The latest data revealed that the euro-zone growth diminished to 0.2% in the second quarter from the previous 0.4%. The year on year rate of growth lessened to just 1.1%. Germany and Italy which are more dependent on exports and manufacturing are experiencing more severe economic feebleness. In addition, there is clear evidence of economic weakness spreading to service based economies. Economic growth in France and Spain slowed to 0.2% and 0.5% respectively in Q2. It was the slowest quarter of growth in Spain since Q2 2014.

On the inflation front, sluggish growth is weighing on price pressures, with core prices dis-inflating from 1.1% to 0.9%. Headline inflation also followed suit from 1.3% to 1.1%, the lowest since February 2018. It's the same old story for the euro-zone. One month of upside surprises on the inflation front is instantly reversed the subsequent month. Core inflation is stuck at around 1%, as it has been for the past four years.

Since euro's sharp deprecation that began in early 2018 has caused only minimal upward trend so far for inflation and may unlikely be able to lift core inflation significantly in the coming months as growth is dwindling by the day even with the EUR/USD trading at more than a two-year low. As for the ECB, officials seemed to be divided on the likely course of action at July's meeting, however the latest dull data should increase the pressure and urgency within the central bank to provide additional stimulus measures.

Over the past week, the single currency (EUR) has lost 0.22% of its value to the U.S. dollar and tumbled to a 26-month low of 1.1025. A streak of negative data from inflation to growth combined with a stronger dollar was a deadly mix for the euro. Investors expect the European Central Bank to take a more aggressive stance on monetary policy easing than the FED, which has reduced demand for the common currency. Data from the Commodity Futures Trading Commission shows that hedge funds have large amounts of short euro positions worth $5.44 billion as of July 26.

UK

Bank of England's Future Path Uncertain

Monetary policy officials around the globe are equipping themselves for a new round of monetary easing, however the BoE confirmed last week that it had no plans to join the global haste to lower borrowing expenses. The Bank of England voted unanimously to maintain its interest rates at 0.75% and their asset purchase program unchanged. In spite of its neutral stance, the Bank shares the depressed view of U.S. and EU policymakers on the dwindling outlook for global growth. The British economy is evidently suffering from the severe Brexit uncertainty and in specific the growing probability of the UK crashing out of the EU without a deal. The Bank's policymakers still maintained that gradual interest hikes are warranted, once Brexit uncertainties are resolved. The reason for the hawkish rhetoric on interest rates is justified by inflation projections. The BoE's forecasts based upon a smooth Brexit, sees inflation exceeding its objective by a significant margin, rising to 2.4% on a three-year period. As for growth expectations, the BoE tapered its growth estimates for 2019 and 2020 to 1.3% for both years from previous estimates of 1.5% and 1.6% respectively.

Usually the deviation in central banks' outlook for borrowing costs would quickly show up in markets. The BoE's hawkish tone on interest rates had minimal effect on FX markets with GBP ending the day close to 30-month low versus the dollar. Global markets have been unresponsive to the MPC's message of late and this is unlikely to change as investors are fixated on the increasing risks of a no-deal Brexit, while the Bank's forecast is based upon a smooth Brexit outcome. Investors and markets were kept in the dark as UK's monetary officials refrained from providing a collective view on what it would do if the worst case outcome did materialize.

In regards to the worst performer among G7 countries, the Sterling pound depreciated by 4.3% in July and by 1.81% last week. The GBP/USD pair dropped to a 30-month low of 1.2077 after the FED's monetary announcement on Wednesday. The pound's severe downward trajectory began after Britain's new prime minister Boris Johnson took over with the explicit agenda of pulling the UK out of the EU by October 31, whether transitional trading agreements are in place or not. The UK has set conditions for negotiations to restart such as to reopen the Withdrawal Agreement for re-negotiation and to scrap the backstop. On the other hand, EU officials have clearly indicated that the Withdrawal Agreement and the backstop in it cannot be amended now. It looks like the two parties are heading for a major showdown that will likely include some degree of constitutional crisis, financial volatility and maybe a general election. Derivative markets suggest investors expect heightened Sterling volatility in late September and into early October.

Asia

Bank of Japan Remains in a Neutral State

The Bank of Japan refrained from further easing monetary policy at its July meeting, maintaining its short-term interest rate target at -0.1% and pledged to guide the yield on 10-year government bonds to around 0%. Despite the Bank's neutral stance, officials indicated their readiness to stimulate the economy "without hesitation" if inflationary pressures continue to subside away from the 2% objective and a global slowdown endangers the country's economic recovery. Price growth expectations for both 2019 and 2020 were lowered by 0.1% to 0.8% and 1.2% respectively.

The imminent absence of policy action from the BoJ reinforces the view that it has less room to loosen policy further to support growth compared to other major central banks. While the BoJ again took a small step to strengthen its easing bias by officially stating it's willing to act, the impact may not be large enough. The key question is what the central bank can do rather than whether they should ease. Overall, the verdict on maintaining its interest rate targets was made by a 7-2 vote, with board members Goushi Kataoka and Yutaka Harada rebelling against a neutral stance.

Looking at the best performing currency last week, the safe haven Japanese yen gained tremendous momentum against the buck after President Trump tweeted that a 10% tariff would be added to the remaining USD 300 billion of goods coming to the U.S. from China. Financial markets are back in risk aversion mode and volatility may further intensify in equity markets and bond yields around the globe. This increased volatility could drive further weakness in the U.S. dollar and help boost the Japanese yen's attractiveness as an instrument to invest in. The USD/JPY fell to the lowest level since the start of the year at 106.59. In weekly terms, USD/JPY is down by 1.88%.

China's Manufacturing Sector Contracted for a Third Time in a Row
China's manufacturing segment improved minimally in June from 49.4 to 49.7, however the index has remained in negative terrain for the past three readings. Moreover, the sector contracted (PMI index below 50) five times out of seven this year. Growth came in at 6.2% y/y in Q2, the lowest reading in 27 years with industrial profits for the first six months of the year declining by 2.4%.

The data suggests sentiment has barely improved in the manufacturing sector even after China and the U.S. reached a truce at the G20 summit. There is still a lot of persistent insecurity around the trade front, which may continue to suppress the overall economy. The negativity seen reinforces the possibility that the government may further uplift the economy through monetary and fiscal tools in the coming months. U.S. officials have downplayed the chance that a trade deal will be struck soon and as long as a trade deal is nowhere to be seen, the global economy will remain on its toes.

Kuwait

Kuwaiti Dinar

USD/KWD opened at 0.30395 on Sunday morning.

Rates – 4 August, 2019

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.1131	1.1025	1.1162	1.1106	1.0925	1.1225	1.1191
GBP	1.2380	1.2077	1.2381	1.2156	1.2175	1.2480	1.2207
JPY	108.64	106.49	109.31	106.58	104.60	107.60	105.91
CHF	0.9930	0.9813	0.9974	0.9820	0.9620	1.0125	0.9742