# Treasury Group
**Weekly Money Market Report**
15 October 2017

# Dollar continues descent amid stubborn inflation

## United States

### Inflation divides FOMC policymakers

Last week, FOMC minutes from the Federal Reserve's September meeting were released as investors awaited the Fed's tone regarding the path of interest rate hikes. The minutes revealed that even though the central bank held its course for a December rate hike, Fed officials differed in opinion over whether the lag in inflation was persistent or temporary. The minutes revealed that "many participants expressed concern that the low inflation readings this year might reflect not only transitory factors, but also the influence of developments that could prove more persistent, and it was noted that some patience in removing policy accommodation while assessing trends in inflation was warranted. A few of these participants thought that no further increases in the federal funds rate were called for in the near term or that the upward trajectory of the federal funds rate might appropriately be quite shallow. Some other participants, however, were more worried about upside risks to inflation arising from a labor market that had already reached full employment and was projected to tighten further."

The report also illustrated the concerns some of the policymakers had regarding waiting too long to raise interest rates, saying that a "slow pace in removing policy accommodation could result in an overshoot of the Committee's inflation objective in the medium term that would likely be costly to reverse or could lead to an intensification of financial stability risks or to other imbalances that might prove difficult to unwind."

Later during the week, and much to the dismay of Federal Reserve officials, inflation figures released on Friday failed to live up to expectations, proving that the time ahead will be of a tricky nature for the policymakers. Core consumer prices, which exclude both food and energy, continued to disappoint, rising only 1.7% y/y in September. This marks the seventh time in 8 months where the figure has failed to meet analysts' expectations. Additionally, the CPI also missed its estimate, coming in at a 2.2% rise y/y. Nevertheless, despite the disappointing inflation numbers, chances of a December rate hike hovered around 74% in terms of market confidence.

On the other hand, figures released by the Commerce Department signaled that retail sales in the US rose 1.6% m/m, a rate that is joint highest since 2009. Driving the high number was a surge in auto sales, which came as consumers rushed to replace damaged vehicles, a result of the series of devastating hurricanes that ravaged the United States' Gulf Coast. Meanwhile, core retail sales, which exclude vehicles, increased 1% m/m, a level that is greater than market expectations and joint highest since 2012.

The dollar was sent downwards by traders as they digested news of the weaker-than-expected inflation. The dollar index reached an October low of 92.749 as it weakened against a basket of major currencies. Moreover, treasury yields also fell, with the benchmark 10-year note reaching a 3-week low of 2.2730 % on Friday while the 2-year note fell to 1.4888%.

Looking at the world economy, the International Monetary Fund revised its world economic forecasts upwards last week, stating that the global economic recovery has strengthened financial stability. The fund upgraded its global economic growth forecast for 2017 and 2018, to 3.6%, and to 3.7% respectively. The improvement was mainly driven by a pickup in trade, investment, and consumer confidence. Nevertheless, the IMF warned policymakers not to get too comfortable and said that the current economic conditions were fuelling an appetite for risk that, together with central banks' response to the 2008 global crisis, appeared to be laying the ground for a new financial crunch. The IMF also cited a $135tn debt pile in G20 nations that borrowers are finding difficult to service. Tobias Adrian, of the IMF's financial stability watchdog stated that "While the waters seem calm, vulnerabilities are building under the surface and if left unattended, these could derail the global recovery."

On the currency front, the Pound Sterling managed to climb steadily throughout the week. That is however until turbulent Brexit negotiations between British diplomats and their European counterparts managed to feed the volatility of the cable. On Thursday, the European Union's chief negotiator Michel Barnier stated that negotiations were at a deadlock and that Britain had told the EU that it was not ready to specify how much it believed it should pay. This sent the pound down 1% against the dollar and to a 30-day low against the Euro. Nevertheless, sterling managed to appreciate to an 11-day high of 1.3336 after reports emerged that the European Union could offer Britain a two-year transitional Brexit deal. The cable, assisted by a soft dollar, ended up closing the week higher at 1.3284.

The Euro managed to steadily climb against the US dollar throughout the week, shrugging off rising tensions in Spain. The single currency was assisted by numerous economic data that proved to be above analysts' expectations as it managed to peak at 3 week high of 1.1880 on Thursday. The Euro closed the week at 1.1822 against a soft dollar.

As for the Japanese yen, it had a subdued week, mainly reacting to the US dollar. The USDJPY pair saw its biggest move on Friday after a disappointing reading of US inflation failed to impress. The pair opened the week at 112.68, and ended up closing lower at 111.84.

Regarding commodities, OPEC announced that it expects demand to strengthen next year, citing higher consumption growth and lower supplies from outside the organization. Demand is expected to reach 33.1 million b/d in 2018, up by roughly 200,000 b/d from last month's forecast. Meanwhile, oil prices firmed up this week as US crude inventories fell by 2.7 million barrels versus an expectation of 1.9m. Also helping lift the price of oil was positive trade data out of China. Eventually, Brent crude managed to reach a high of $57.57 before closing the week at $57.20

### US producer price index

US producer prices increased by 0.4% m/m in September, the largest increase since April. The figure was driven largely by a 10.9% increase in gasoline prices due to the hurricanes which reduced the Gulf Coast's refining capacity. Data from the Bureau of Labor Statistics also showed that the index for final demand services increased 0.4%, while the prices for final demand goods rose 0.7%, the largest increase since moving up 1.0% in January.

## Europe & UK

### UK industrial output

In the UK, output in the industrial sector improved for a third straight month in August, with a much better than expected improvement in manufacturing pushing growth to its highest level since February. Manufacturing production increased at a level of 0.4% m/m versus a market expectation of 0.2%. Furthermore, overall industrial production increased 1.6% y/y, twice as fast as the 0.8% rate predicted by analysts. Meanwhile, the UK's total trade balance deficit widened by 2.9 billion pounds to 10.8b while the total goods and services deficit widened by 6.2b to 13.2b.

### Germany trade balance

Germany saw its largest export growth in 12 months, with the trade surplus widening to 21.6 billion euros as exports outpaced imports, defying a strong euro. Based on provisional data, the Federal Statistical Office also reported that German exports and imports increased by 7.2% and 8.5% y/y respectively in August. Compared with July 2017, exports increased by 3.1% and imports by 1.2% in calendar and seasonally adjusted terms. The figures suggest that the German economy, the euro zone's growth engine, is set for a solid expansion in the third quarter despite uncertainties about the make-up of the next government following national elections last month. The euro reached an October high of 1.1880 as it appreciated against the US dollar.

### Eurozone industrial production

The Eurozone witnessed its highest level of industrial production in 2017, exceeding analysts' expectations. During August of 2017, seasonally adjusted industrial production rose by 1.4% in the euro area and by 1.7% in the EU28, according to official figures released by the Eurostat. During the prior month, industrial production rose by 0.3% in the euro area and fell by 0.3% in the EU28. The 1.4% rise was mainly due to production of capital goods rising by 3.1%, durable consumer goods by 1.3%, intermediate goods by 1.2%, and energy by 0.2%. Notably however, output in France's industrial sector unexpectedly pulled back in August after a fall in manufacturing of machinery offset gains in transportation equipment. Industrial output fell by 0.3% m/m whereas analysts were expecting a 0.4% increase.

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## Asia

### Japan core machinery orders

Japan's core machinery orders increased well above expectations in August. The seasonally adjusted figure came in at 3.4% m/m versus an expectation of a 0.9% increase. Even though the increase was the second highest in 8 months, only lower than the prior month's 8% m/m increase, the value of core orders was the highest since July of 2016, at 882.4 billion yen. Core machinery orders are a leading indicator of production, and usually signal the level of capital spending in the coming nine months. Prime Minister Shinzo Abe will be especially delighted to hear of any positivity in the Japanese economy in order to bolster his position in the upcoming elections this month.

### China trade balance

China's trade balance reached a six-month low as its imports rose 18.7%, exceeding estimates with the fastest growth since March to result in a trade surplus of $28.5 billion. As for exports, demand for Chinese products have proven to be healthy as the dollar value of outbound shipments rose 8.1% y/y to a level of $169.8bn. The data also showed that China's trade surplus with the United States reached a record high of $28.1 bn. Meanwhile, Chinese imports from North Korea fell 37.9% and exports dropped by 6.7% amid nuclear tensions with the defiant regime. Elsewhere in the region, trade has also been strong. Exports surged to records last month in both South Korea and Taiwan, while August data has shown strengthening in Thailand, Malaysia and Singapore as the International Monetary Fund raised its global growth forecast as well as its estimate for China.

### China manufacturing

In China, latest data from IHS Markit casts doubt over the strength reported by the Chinese government's official figures earlier. IHS Markit suggests that activity levels across China's manufacturing and services sectors slowed sharply in September. The service sector expanded at its weakest pace in almost two years as the pace of new businesses cooled down. The services PMI declined to 50.6, the lowest reading since December 2015 and one of the weakest since the survey began in 2005. The survey was in contrast to an official gauge of the non-manufacturing sector that showed the services sector expanded at the fastest momentum since 2014, clouding the picture on the performance of the economy.

## Kuwait

### Kuwaiti Dinar at 0.30180

The USDKWD opened at 0.30180 on Sunday morning.

## Rates – 15th October, 2017

| | Previous Week Levels | | | | This Week's Expected Range | | 3-Month |
|---|---|---|---|---|---|---|---|
| Currencies | Open | Low | High | Close | Minimum | Maximum | Forward |
| EUR | 1.1727 | 1.1716 | 1.1880 | 1.1822 | 1.1615 | 1.1930 | 1.1885 |
| GBP | 1.3067 | 1.3054 | 1.3336 | 1.3284 | 1.3085 | 1.3380 | 1.3327 |
| JPY | 112.68 | 111.67 | 112.82 | 111.84 | 109.85 | 113.95 | 111.34 |
| CHF | 0.9779 | 0.9703 | 0.9807 | 0.9743 | 0.9545 | 0.9940 | 0.9683 |