Treasury Group
Weekly Money Market Report
24 December 2017

US Tax Reform Approved by Congress

United States

Dollar Remains Subdued Despite Tax Amendment

The US tax reform has been signed into law by President Donald Trump and the majority of alterations in the bill will take effect as of January the first 2018. The interesting issue is that the largest tax reform in US history in terms of size wasn't a market mover. It was evident that the tax factor was already priced in over the course of the year. Lately, the market's tone toward the benefits of the tax cut has been subdued, as they expect the positive effects to be overshadowed by higher interest rates stemming from the enhanced government deficits. The tax reform will cost roughly USD1.5 trillion over the next 10 years. The US central bank predicts a "modest lift" to economic growth from the tax modification and that's why the FED increased the growth forecast to 2.5% for 2018 from 2.2%, afterwards they expect growth to slip back closer to its recent 2% average.

In Catalonia, the pro-independence parties won the regional election and retained their majority in the parliament. The separatists' parties won 70 of the 135 seats, while the pro-Spain parties won 57 seats. The results of the election may cause tensions to re-emerge between Madrid and the pro-independence faction eager to exploit the tactical advantage of a favorable election outcome. The overall impact of the vote on the single currency was minimal and Catalonia may find it difficult to develop into an independent state if no other country recognizes its sovereignty. It won't even be able to have its own currency under such circumstances. The EU mostly likely won't support a pro-independent state, especially during ongoing negotiations with the UK. The pro-separatist parties are somewhat divided and the previous independence declaration created tensions between the parties over policy direction.

On the currency front, the dollar index was pressured downwards at the start of the week as markets awaited the outcome of the vote from Congress. The downward direction persisted as the euro's strength took its toll on the greenback and final US GDP reading came in lower than expected. Despite positive news from the tax reform and higher US yields the DXY failed to gain support. The Dollar was the second weakest major currency last week after the Japanese yen and lost 0.55% of its value.

As for the single currency, the euro took advantage of the Dollar's weakness last Monday and received a boost after inflation moved in the right direction. The EUR/USD gained momentum throughout the week, until the election results from Catalonia came out. The pair opened the week at 1.1751 and closed on Friday 1.1857.

The Sterling pound's direction last week was influenced by the majors as it was a light week in terms of economic data. The Sterling appreciated sharply at the first day of the week before entering into a consolidative tone, which persisted until Friday.

The safe haven yen was the worst performing major currency last week, pressured by powerful rally in treasury US yields. The dollar hit a nine-day high against the yen on Thursday, after comments by Governor Haruhiko Kuroda reinforced expectations that the BOJ was in no hurry to move away from its ultra-loose monetary policy. The dollar was supported against the yen after the 10-year yield jumped to a nine-month high as investors worried the tax refurbishment could lead to higher US debt. The US dollar gained 0.53% over the yen throughout the week.

In the commodities complex, the price of oil edged higher on Monday, supported by a North Sea pipeline outage and a Nigerian oil worker strike. Moreover, the upward trend continued after US crude oil inventories declined by 5.222 mn barrels last week, according to data from the American Petroleum Institute, compared to an expected draw of 3.518 mn barrels. Brent crude oil closed the on Friday at $64.95.

US Gross Domestic Product

The final value of all goods and services produced in the third quarter edged lower to 3.2% annually, from an earlier estimate of 3.3%. The slight downward movement is attributed to weaker trade and consumer spending. Personal consumption, which makes the biggest contribution to the economy's growth, was revised down to a 2.2% from 2.3%. Although, this doesn't change the fact that it was the first time since 2014 that the economy enjoyed growth of 3% or more for two consecutive quarters. The Federal Reserve lately enlarged its calculation for growth next year to 2.5% from 2.2% in expectation of a tax change.

Economic figures ranging from the labor market to the housing sector as well as other reports, suggested the economy maintained its solid momentum into the fourth quarter. Looking forward, markets expect a modest boost for the next two years due to changes in the tax model and a pickup in the global economy. In spite of the latest tax amendment, several economists predict a moderate boost to the economy as tax cuts for individuals is skewed towards higher-income households. Several economists believe the lower tax regime will lead to share buybacks and debt repayment rather than a boost in business investment.

Housing Sector likely to Support Q4 Growth

Last month's gains in new home constructions are inspiring, as they are motivated by single-family home building, which tends to increase economic activity and jobs in a bigger way than apartment construction. Single-family licenses have risen for three consecutive months, suggesting a sustained pipeline of work for developers. The recent data increases the probability that residential construction spending, which negatively impacted Q2 and Q3, will add to the pace of growth in the last quarter of 2017. In details, housing starts rose 3.3% to an annualized rate of 1.3 million from 1.29 million seen in October. The latest rate indicates the data is the highest level since October 2016.

Looking at building permits, an indicator of future construction, dipped 1.4% to a rate of 1.298 million. The decline is attributed to a fall of 6.4% in permits for the construction of multi-family homes. In conclusion, confidence among home builders is at 18 years high, with relatively low mortgage rates. The average rate on 30-year fixed US mortgages is lower by 0.23% than a year earlier. The figures reflect a boost from rebuilding and recovery efforts following hurricanes Harvey and Irma after areas in the South had faced the brunt of the damage from flooding and winds.

Europe & UK

Business Confidence Negatively Impacted by Politics

Morale in German businesses drifted lower this month, over the shape of the new government as Chancellor Angela Merkel struggles to form a firm government. Merkel's party lost supporters to the far right in September's election and her attempt to form a three-way alliance failed last month. After recording an all-time high in November, Ifo business climate index contracted 0.4 points to 117.2, pressured by attitudes toward business prospects over the next six months. Despite the drop in the German Ifo Business Confidence, the present conditions index improved to 125.4 from 124.5 last month. Overall, the Ifo climate index remains near record highs, while growth projection by the government and Bundesbank have been upgraded.

Inflation Edges Up in Europe

Consumer inflation in the Eurozone slightly increased 0.1% in November to 1.5% y/y, while the core rate remained stagnant at 0.9%. The main contributor that supported the rise in headline inflation was oil prices. German inflation rose back to September's level of 1.8% annually, having dropped to 1.5% in October. The highest annual rates were recorded in Estonia (4.5%), Lithuania (4.2%) and the United Kingdom (3.1%).

The European Central Bank expects consumer price growth to dip before slowly picking up again and to float around the 1.5% level until 2020, when it rises to 1.7%. The Bank enhanced its growth prospect for 2018 from 1.8% to 2.3%. Overall, economic indicators are at multi-year highs suggesting the robust momentum will likely continue.

UK's Economy Misses out on Global Recovery

The final calculation of Q3 growth in the United Kingdom revealed that British consumers financed their expenditures by saving less. The saving ratio fell to 5.2% from 5.7% seen in the second quarter mainly due to consumer prices exceeding wage growth. Households have now been net borrowers for four successive quarters for the first time since records began in 1987. In details, the economy grew 0.4% in Q3, taking the annual rate up to 1.7% from an earlier estimate of 1.5%. But despite being revised higher, that's still the lowest annual growth in over 4 years. In regards to the IMF, they predict the economy to slow down further next year to 1.5%.

The Recruitment and Employment Confederation claimed that fewer UK employers plan to hire extra staff next year on the back of a gloomy outlook. The REC survey revealed the net balance of companies planning to add permanent staff in the next 12 months fell to 16% in November from 24% a year ago. No companies in the survey said they expect the British economy to improve in 2018.

Asia

No Exit in Sight

In his last monetary meeting of the year, BoJ Governor Kuroda poured cold water on speculation that the central bank is gunning up to tighten its monetary stance . The Governor claimed "just because I brought up this academic analysis, reversal rate, doesn't mean at all that we need to review or change the yield curve control we've adopted since September last year.

The Japanese economy is in great shape in terms of growth, job creation and price expansion is at least moving in the right direction. The BoJ's tone lately indicates confidence in the strength of the economic recovery as the economy expanded at an annualized 2.5% in Q3 2017, to mark a seventh straight quarter of growth. Inflation is still far away from the 2% level and there isn't much pressure on Kuroda to elevate rates by the government after he has been called to parliament only 19 days this year. That's down from 51 days last year and is the fewest for any BOJ governor since 2007. The overall data supports the case that the central bank will maintain its negative interest rate model until price growth lands towards the 2% target.

In details, the BOJ hasn't amended its monetary policy since September 2016, when it employed its yield-curve control program, setting an interest rate of -0.1% on some bank reserves and a target of around 0% for 10-year government bond yields.

RBA's Monetary Policy Remains Unchanged

The Reserve Bank of Australia's meeting report was released last week after maintaining its cash rate at 1.5% on December the 5th. The RBA has restrained itself from tightening monetary policy for the last seven years. As for the labor market, the environment remained positive as overall growth in employment has increased slightly and full-time employment is growing at its fastest pace in a decade. The unemployment is currently at 5.4%, the lowest since 2013.

The RBA cautioned that the outlook for household consumption continued to be a significant risk due to a modest rise in wages, while household debt levels were extremely high. Household consumption rose 0.1% in the three months through September, its weakest pace in five years. The Board judged that retaining the stance of monetary policy at this meeting would be consistent with sustainable growth in the economy and achieving the inflation target over time. In regards to expectations, interbank futures and financial market prices indicate that the cash rate is expected to remain unchanged for the time being.

Kuwait

Kuwaiti Dinar

The USDKWD opened at 0.30190 on Sunday morning.

Rates – 24 December, 2017

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	High	Low	Close	Open	High	Forward
EUR	1.1753	1.1901	1.1736	1.1857	1.1760	1.1960	1.1940
GBP	1.3325	1.3420	1.3307	1.3360	1.3260	1.3465	1.3415
JPY	112.62	113.63	112.30	113.26	112.35	114.40	112.55
CHF	0.9903	0.9917	0.9826	0.9891	0.9765	0.9975	0.9811