# Treasury Group
## Weekly Money Market Report
06 May 2018

# US Dollar Rally Continues as Markets Return to Fundamentals

## United States

### FOMC Signals Higher Inflation & Mixed Jobs Report

The US dollar rally continued last week on expectations the US Federal Reserve and other central banks would continue to diverge on monetary policy. Markets see the Fed raising interest rates at least two more times this year while expectations of policy tightening from the European Central Bank and the Bank of England have receded further, strengthening the dollar. That view was reinforced as the recent flow of economic data from Europe and the UK in particular suggested moderating growth in the competing economies.

While the other major economies are struggling to get a proper footing on inflation, the US has essentially met its 2% target. The Fed's preferred inflation reading the Core PCE index was last measured at 1.9% year on year. In the FOMC meeting last week, policy makers acknowledged that both headline and core inflation have moved close to their 2% goal while dropping the reference that they are monitoring inflation developments closely. The Fed's confidence in inflation was bolstered further as they changed the description of their inflation target to "symmetric." The Fed's emphasis on the symmetrical nature of their inflation goal signals that they will tolerate a modest inflation overshoot beyond 2%. As a result, it should help moderate building expectations for the Fed to announce plans for an even faster pace of the rate hikes in the year ahead.

Looking at the Fed's other main concern when hiking rates, the US labor market released mixed numbers last week. Non-farm employment increased by 164,000 jobs last month, according to the Bureau of Labor Statistics, recovering from an upwardly revised 135,000 in March. However, this fell below economists' expectations for a gain of 192,000. At the same time, the unemployment rate fell to 3.9%, from 4.1% in March, partly due to a decrease in the labor participation force. Finally, the closely watched average hourly earnings number rose by 4 cents, equating to a 2.6% annualized gain, 0.1% lower than the previous month and a slightly less than expected. While the data may indicate that the US labor market may still have room to improve after years of gains, markets were unfazed. The US dollar index jumped to a 2018 high of 92.90 after the release.

## Europe & UK

### Slowing Growth in Europe

In the Euro zone, the euro remained pressured by the US dollar rally while recent developments were dampening ECB tightening expectations. The release of the latest euro-zone GDP report for Q1 confirmed that the economy slowed at the start of this year. At the same time core inflation in the euro-zone fell to just 0.7% in April driven down in part by the timing of Easter. The European Central Bank however, is unlikely to pay much attention to the inflation report for April because all the readings were distorted by the timing of Easter. Instead, the Governing Council is likely to focus on signs of increased wage growth for price pressure indications. Finally, the combination of a relatively muted response from the ECB's last meeting on monetary tightening and the move higher in US yields versus Euro zone yields is also weighing on the EUR/USD.

### Disappointing Data Supports a Pass on an Interest Rate Hike in May

In a similar fashion, the British pound has also been falling against the rallying US dollar. Increased Brexit uncertainties, weak figures and a sharp pull back in Bank of England rate expectations have all aided in the downturn in sterling. A May rate hike is now seen as largely dead in the water after the recent economic data flow has heightened concern that the UK economy could now be experiencing a more material slowdown. Indeed, the latest PMI surveys show growth in the manufacturing and services sectors slowing to 17 months lows. UK PMI manufacturing dropped to 53.9 in April from 55.1 with the trend in manufacturing production likely to remain subdued in Q2. The services sector showed a similar picture subdued new business growth which contributed to a further slowdown in the rate of job creation. Meanwhile, survey respondents also noted that higher payroll costs continued to drive up operating expenses and place a squeeze on margins. The disappointing data makes a near term hike in interest rates by the Bank of England look increasingly more remote.

## China

### China Economy Stable

In China, factory growth slowed slightly in April showing activity in the world's second largest economy holding up despite worries over trade tensions with the US. The official purchasing managers' index came in at 51.4 for April, easing from 51.5 in the previous month but still above the 50-point mark that separates expansion from contraction on the index's 100-point scale.

The China Federation of Logistics & Purchasing's survey found that factory output was stable but new orders and new export orders weakened for the month, indicating slowing demand. The release came amid simmering trade tensions between Beijing and Washington, with potential implications for China's sprawling export-oriented manufacturing sector. This trade conflict will be in the spotlight again this week as US Treasury Secretary Steve Mnuchin leads a delegation to Beijing for talks aimed at defusing the threat to economic relations between the world's two largest economies.

Activity in the rest of China's economy also held up fairly well, with further growth in the services sector, which is playing an increasingly important role as communist leaders in Beijing pivot the country away from its agricultural and industrial roots. The group's non-manufacturing purchasing managers' index rose to 54.8 from 54.6 in March.
The latest numbers eased fears about a slowdown in China's economy, which grew at an unchanged 6.8% pace in the first quarter. Forecasters are expecting growth to cool this year as Beijing tries to rein in rising debt levels.

## Australia

### Reserve Bank of Australia Leaves Policies Unchanged

The Reserve Bank of Australia held its rates unchanged for the 21st straight month in their last meeting while signaling a continuation of easy policy for some time yet. The RBA left growth forecasts unchanged from its February outlook, while estimates for inflation and unemployment this year were nudged up a little. The jobless rate is seen remaining at 5.5% this year before easing to 5.25% by mid-2019 and staying there to 2020. Underlying inflation is now seen at the lower end of its 2-3% target by mid-2018 and is still not expected to reach 2.25% until June 2020. Governor Philip Lowe pointed to subdued wages growth, at 2%, as a major factor weighing on inflation, but held out hope for a pick as the economy revives and the labor market tightens.

The Reserve Bank of Australia expects growth in the economy to accelerate to 3.25% by the end of this year before peaking at 3.5% by June 2019. "Overall, the Australian economy is progressing broadly on the track the Bank has been expecting for a while. The current accommodative stance of monetary policy has assisted this outcome," Lowe said.

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## Kuwait

### Kuwaiti Dinar at 0.30130
The USDKWD opened at 0.30130 on Sunday.

## Rates – 06 May, 2018

| | Previous Week Levels | | | | This Week's Expected Range | | 3-Month |
|---|---|---|---|---|---|---|---|
| Currencies | Open | High | Low | Close | Minimum | Maximum | Forward |
| EUR | 1.2123 | 1.2139 | 1.1909 | 1.1958 | 1.1815 | 1.2085 | 1.2042 |
| GBP | 1.3785 | 1.3792 | 1.3485 | 1.3530 | 1.3345 | 1.3665 | 1.3595 |
| JPY | 109.00 | 110.02 | 108.62 | 109.11 | 108.15 | 110.50 | 108.43 |
| CHF | 0.9873 | 1.0022 | 0.9869 | 0.9997 | 0.9870 | 1.0100 | 0.9920 |