Treasury Group

Weekly Money Market Report

4 February 2018

FOMC expects "further" gradual rate hikes

United States

During its first meeting of the year, the US Federal Reserve kept interest rates unchanged on Wednesday, as expected. Nevertheless, the Fed still expects "further" gradual rate hikes as it reiterated its views that inflation will rise this year. As per tradition, markets are pondering over whether the introduction of the word "further" means that a rate hike is going to be announced during the FOMC's next meeting, or if it's a signal that the Fed wants to encourage market participants to continue pricing in more rate hikes for the coming years. This comes as markets are confidently expecting a rate hike during the Fed's next meeting in mid-March. Looking further into the future however, the US rate market still does not expect the Fed to raise rates beyond 2.5% in the current tightening cycle. This leaves some additional room for market rates to converge towards the Fed's current plan to increase interest rates over 3% by 2020.

Furthermore, the FOMC statement added that inflation will stabilize around the 2% target over the medium term. The central bank mentioned solid gains in employment, household spending and capital investment as catalysts that will spur growth at a moderate pace in the US economy.

Moving forward, the Federal Open Market Committee (FOMC), the committee in charge of setting US interest rate policy, is due to undergo major changes. First, Jerome Powell will replace Janet Yellen, which has chaired her final meeting last week. Yellen's departure will leave behind four empty seats on the Fed Board of Governors, which hold permanent seats on the FOMC. The man responsible for filling those seats is Donald Trump. President Trump has the rare opportunity to put his personal mark on the makeup of the Fed. Be that as it may, forecasting the nature of the president's future candidates might prove to be a tricky task. This is because Trump, as a presidential candidate, condemned the Fed's promotion of low interest rates as feeding a risky economic bubble. After taking office and witnessing the stock market rally, however, it seems the president has had a change of heart. Trump now loves low interest rates. Nevertheless, one thing Trump has not changed his mind on is looser financial regulations.

Due to the sensitive nature of the FOMC's responsibility and the enormous weight of its decisions, a proposal is being considered by a House of Representatives subcommittee to expand the number of voting members in the FOMC to include all twelve regional bank presidents, as opposed to the current five. Currently, the FOMC is made up of 12 seats. Seven are held by Fed Board of Governors while five are held by regional bank presidents which rotate every year (with the exception of the NY Fed.) Since presidentially appointed Fed governors would be outvoted by bank presidents who are selected by directors of their institutions, this change would essentially decrease the influence of politics on monetary policy. The subcommittee has reasoned that the proposal ensures that monetary policy decisions can accurately reflect the level, quality and distribution of economic activity throughout the Federal Reserve System. Considering the way Trump is handling his tenure as president, this bill would add welcomed stability in the US economy.

Towards the end of last week, US employment data managed to impress markets, providing some much needed relief for the dollar. Average hourly earnings rose 0.3% m/m in January, above the level expected by economists. Additionally, December's figure was revised upwards to indicate a 0.4% m/m gain. The year-on-year increase in average hourly earnings rose to 2.9%, the largest increase since June of 2009, while December's y/y figure stood at 2.7%. At the same time, the number of jobs jumped by 200K, well above the level of 181K expected by markets. Last month's figure was also revised upwards to 160K. Meanwhile, the unemployment rate stood unchanged at 4.1%, a 17-year low.

Meanwhile in Europe, as the EU pressures the UK in their ongoing Brexit negotiations, a confidential UK government analysis has been leaked. The document is an economic assessment of the different possible outcomes for the UK's trade relation talks with the EU, which concludes that the British economy will be worse off in all of them. The "best" outcome, according to the document, is that the UK remains in the single market but not the customs union and presumes that the economy will be 2% smaller in 15 years than what it would have been had the UK avoided Brexit. Furthermore, the paper describes the "worse" outcome as one where the UK has no preferential market access beyond the World Trade Organization, which would cost the economy 8% over 15 years. The document also describes a third option (the "Canada model"), which would see the economy take a 5% hit over the same period of 15 years.

On the foreign exchange front, the dollar index failed to recover after it reached a 3-year low last week. A number of factors have contributed to the weakness of the greenback. These include recent comments from White House officials which have prompted fresh worries over trade protectionism. Also, another government shutdown may also be on the horizon, as the current continuing resolution expires on February 8th. Furthermore, political uncertainty amidst a dysfunctional white house has showed no signs of slowing down. Towards the end of the week however, solid numbers in the employment report managed to aid a wounded dollar.

On the other side of the coin, the Euro remained supported despite a hawkish FOMC statement, which indicated the need for "further" gradual rate hikes. Despite some volatility throughout the week, better than expected US employment data managed to minimize the pair's weekly change. The EURUSD pair closed the week at 1.2460.

With regards to the sterling pound, the GBPUSD pair reached a 10-day low after a leaked government analysis concluded that the British economy would end up being worse off under all possible Brexit scenarios. The dip in the exchange rate was short lived however, as the GBP ended the week at 1.4120.

In China, the yuan has experienced its strongest monthly rally in almost 40 years in January. Since the beginning of the year, the yuan has gained more than 3% in value amid overall dollar softness. The yuan has reached levels last seen in early August 2015 when the People's Bank of China shocked global markets with a 2.1% one-step devaluation. Recent surveys have indicated that a rising number of exporters are getting worried about a stronger Yuan. Meanwhile however, with the lingering threat of capital outflows, as well as the risk of exacerbating trade tensions with the Trump White House, markets do not expect the Chinese government to take action anytime soon.

US Consumer Confidence

Optimism of U.S. consumers proved greater than expected after the Consumer Confidence Index came at 125.4, a comfortable increase over the forecasted 123.2 and the upwardly revised 123.1 in December. Climbing towards the 17 year high of 129.5 reached in November, the upsurge followed tax cuts signed by President Donald Trump and a record run of the stock market. The higher sentiment will probably underpin household spending, which accounts for about 70 percent of U.S. economic activity.

Canada GDP

The Canadian economy expanded by 0.4% in November, rising after six months of lackluster figures. The growth in the gross domestic product was led by manufacturing, with temporary shutdowns for automobile and chemical plants coming to an end. In addition, the GDP was also complemented with smaller contributions by 16 out of 20 industries including the real estate, oil and gas, and wholesale sectors. On the foreign exchange side, coupled with a weak greenback, the Canadian dollar has appreciated to its highest level since September.

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UK & Europe

UK Manufacturing and Construction PMI

The United Kingdom's manufacturing PMI failed to live up to analysts' expectation as it came below last month's level. The level of Britain's manufacturing output rose at the slowest pace since August. Meanwhile, construction output barely recorded an increase as the construction PMI eased to a 4-month low of 50.2. The report, prepared by IHS Markit, stated that "survey respondents reported increased hesitance among clients to invest in new projects amid heightened concerns over the UK economic outlook. Encouragingly, however, firms generally expect things to improve later in the year." The report also indicated that "a contraction in house building added to lackluster commercial building and civil engineering markets, and reduced inflows of new work suggest overall activity could slip into decline in February. Furthermore, cost pressures remained intense, fuelled by shortages of input materials and high costs for imported products."

Eurozone Inflation

In the Eurozone, inflation fell to 1.3% y/y in January, as expected by economists. The figure is tied for the lowest in one year. Meanwhile, core inflation, which excludes volatile items, was at 1.0% during the first month of the year. Nonetheless, the ECB has already indicated that it expects a slowdown in inflation over the coming several months, which gives officials more breathing room over when to end their quantitative easing program and start tightening monetary policy. In spite of inflation not meeting the ECB's 2% target, the current situation is considerably better now compared to the same period last year, where the central bank was dealing with the threat of deflation.

Asia

Australia CPI

Core inflation in Australia continued to evade the RBA's long-term target of 2-3% during the final quarter of 2017. The annual consumer price index ended the year at 1.9%, marking a period of eight straight quarters where inflation failed to live up to the central bank's target. Wage growth, which has recently slowed to historic lows, has been identified as the main culprit. Meanwhile, the Reserve Bank of Australia has continued to keep interest rates at an all-time low of 1.5% since 2016.

China PMI

Data out of China indicated that manufacturing activity came in below expectations at 51.3. Even though the figure is above 50, indicating an expansion in the sector, it is a slowdown from December's level. After an unexpectedly strong year, analysts are predicting a cool down in the Chinese economy this year. On the other hand, the Chinese service industry saw accelerated growth in January, with the official non-manufacturing PMI rising to 55.3.

Kuwait

Kuwaiti Dinar

The USDKWD opened at 0.29960 on Sunday morning.

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Rates – 4th February, 2018

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.2425	1.2333	1.2522	1.2460	1.2255	1.2665	1.2537
GBP	1.4161	1.3977	1.4277	1.4120	1.3925	1.4345	1.4174
JPY	108.68	108.40	110.47	110.09	108.15	112.15	109.51
CHF	0.9353	0.9254	0.9393	0.9310	0.9125	0.9515	0.9246