Treasury Group

Weekly Money Market Report

25 March 2018

Fed hike fails to lift dollar

United States

In what was a relatively eventful week, the Federal Reserve marched on with the first interest rate hike of 2018. The FOMC, the committee in charge of setting US monetary policy, raised the target range for the federal funds rate by a quarter point to 1.5-1.75% as it predicted inflation would accelerate in the coming months.

Regarding the Fed's long term plan, the updated dot plot indicated that three hikes are predicted in 2019, as opposed to the two predicted back in December. In addition, policymakers foresaw two hikes in 2020, rather than one. As a result, the projected terminal Fed funds rate during the current tightening cycle has been raised to around 3.5% up from just over 3.0% back in December.

As for its views on the economy, the central bank signaled increased confidence while citing an improved growth rate of 2.7% and 2.4% by 2018 and 2019, respectively. Moreover, the updated unemployment outlook included a drop to a figure of 3.6% in the next two years, the lowest since the late 1960s and nearly 1 percentage point below the Fed's estimate of the longer run jobless rate.

Despite the fact that the Federal Reserve raised rates and upped its long-term target rate, its policy outlook failed to reverse the US dollar's weakening trend. The dollar index dropped to a 30-day low immediately after the statement, and is now 3% lower since the beginning of the year. The dollar also notably lost 10% of its value against a basket of currencies in 2017.

In a significant event towards the end of the week, the Trump administration signaled its intent to levy tariffs of 25% on up to $60bn in annual imports from China, raising fears of a trade war between the world's two largest economies. According to the US Government, China has engaged in widespread theft of American intellectual property. The alleged practices range from counterfeiting famous brands and stealing trade secrets to pressuring companies to share technology with Chinese companies to gain access to China's vast market. U.S. officials were said to find strong evidence that China uses foreign-ownership restrictions to compel American companies to switch technology to local firms and that China supports and conducts cyber-attacks on U.S. companies to access trade secrets.

The tariff is to be imposed as punishment after China's efforts to improve its intellectual property framework was deemed not fast enough. Furthermore, the $60 billion figure is based on U.S. estimates of the lost corporate earnings caused by China's alleged IP theft or forced technology transfers. Mr. Trump cited that Beijing had for decades unfairly acquired US intellectual property and needed to pay the price. Trump added that the tariffs would "make us a much stronger, richer nation". They would also help address the US's $375bn trade deficit with China, he added, calling it "the largest deficit of any country in the history of our world. It is out of control."

Hours later, China returned the favor by announcing a plan to impose its own tariffs on US imports worth up to only $3 billion. It is important to note however, that this reaction is said to be a response to the previously announced steel and aluminum tariffs by the US. Observers have described China's reaction as restrained in an effort to avoid a trade war.

Nevertheless, prospects of a trade war did not sit well with investors. The Dow Jones Industrial Average lost 700 points while the S&P 500 dropped 2.5% after a sell-off was triggered. On the other hand, demand for safe assets increased. The US 10-year yield retreated towards 2.8% while the Yen broke the 105 level for the first time since Trump was elected as President.

Also taking place last week was the G20 summit, where financial decision-makers from all over the world stressed over the importance of free trade. In a time where the United States is moving towards trade protectionism practices, world leaders of the largest 20 economies warned over the dangers that a potential trade war carries. "The first risk is the risk of inward looking policies and protectionism," European Commissioner for Economic and Financial Affairs Pierre Moscovici told reporters after the first day of talks. Protectionism could damage growth, he added.

On the foreign exchange front, the Euro started the week off with a bang thanks to relatively smoother Brexit negotiations. However, a sharp decline in the ZEW Indicator of Economic Sentiment for Germany put a damper on the single currency's rise as it reached a 20-day low of 1.2237. ZEW President commented on the survey saying: "Concerns over a US-led global trade conflict have made the experts more cautious in their prognoses. The strong euro is also hampering the economic outlook for Germany, a nation reliant on exports. Combined with the experts' continued positive assessment of the current situation, however, the outlook is still largely positive." Nevertheless, the Euro rose on the back of a weak dollar towards the end of the week, ending it higher at 1.2351.

The sterling pound benefited from a slew of positive news last week. The pound got its first boost after the UK and the EU reached an initial agreement over Brexit. Later during the week, wage data lifted the pound against a weakening dollar as the latter lost ground across the board. The GBPUSD pair opened the week at 1.3930 and closed it 1.5% higher at 1.4132.

UK & Europe

Meanwhile in Europe, the UK and the EU have finally agreed on initial terms over Brexit. Negotiators from both sides described the deal as a "decisive step" in the Brexit process. The agreement will serve to oversee the "orderly withdrawal" of the UK during the transitional period, which is defined as lasting from March 2019 until December 2020. As a result, markets traded the pound higher as sentiments regarding the pound were lifted.

In the UK, the BOE held interest rates at their current levels during its meeting last week, although the vote was split 7-2. The central bank is strongly expected to implement the next hike during its May meeting, with confidence levels reaching 86%. Furthermore, the Monetary Policy Committee maintained its pledge that any future rate rises "were likely to be at a gradual pace and to a limited extent", a commitment that has persuaded financial markets not to expect more than two rate rises this year.

Meanwhile, employment figures in the UK comfortably beat expectations. The unemployment rate fell to 4.3% while total pay gains rose to 2.8% in the three months to January. That data beat the consensus of 2.6%.

On the other hand, headline inflation in the UK slowed down to 2.7% this February from January's 3%. The figure was slightly below the median estimate as well as below the 2.9% projected in the BOE's February inflation report. Core inflation also slowed in February, to 2.4% from 2.7% in January. The slowdown reflects the diminishing impact of previous declines in sterling. The fall in sterling, driven by Brexit, has pushed inflation up for the last 18 months. Categories which are sensitive to the exchange rate such as food, fuel and recreational goods contributed negatively to the change in the headline rate.

Kuwait

Kuwaiti Dinar

The USDKWD opened at 0.29945 on Sunday morning.

Rates – 25th March, 2018

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.2282	1.2237	1.2388	1.2351	1.2140	1.2555	1.2440
GBP	1.3930	1.3910	1.4216	1.4132	1.3925	1.4345	1.4193
JPY	105.94	104.62	106.63	104.72	102.85	105.65	104.06
CHF	0.9519	0.9443	0.9566	0.9470	0.9285	0.9675	0.9395