Treasury Group

Weekly Money Market Report

01 October 2017

The US dollar rallies on tax reform hopes

United States

Fed Officials are willing to hike

Last week, the dollar recovered on the back of interest rate hike expectations and the proposed tax reform from the Trump administration. Fed Chair Janet Yellen admitted that trends in employment and wage and price pressures have shifted from what central bank forecasters expected. "My colleagues and I may have misjudged the strength of the labor market, the degree to which longer-run inflation expectations are consistent with our inflation objective, or even the fundamental forces driving inflation," Yellen said. The speech comes less than a week after the policymaking Federal Open Market Committee approved the first steps in unwinding some of the stimulus the Fed has provided since late-2008. The central bank will begin rolling off some of the bonds it holds on its $4.5 trillion balance sheet. In addition, Yellen added that regular pace of rate hikes ahead is still likely warranted, though Fed officials are looking closely at the assumptions underlying those projections.

Furthermore, addressing current economic conditions, Yellen said the Fed still expects longer-run inflation to trend toward the 2 percent target policymakers believe is healthy for economic growth. However, she said they are making room for the possibility that they're wrong. "How should policy be formulated in the face of such significant uncertainties?" she said. "In my view, it strengthens the case for a gradual pace of adjustments. Moving too quickly risks over adjusting policy to head off projected developments that may not come to pass." While lower inflation and interest rates sound beneficial, Fed officials worry that keeping rates lower allows little room for stimulus when another economic slowdown hits. Yellen's comments reflected those from a paper released this week from the San Francisco Fed, where economists worried that a lower "neutral rate," or that which keeps the economy in equilibrium, also limits the monetary policy options. It is worth mentioning that interest rate expectations in the US reached 70% after Yellen's speech.

On the tax reform plan, President Donald Trump and Republican leaders will launch an urgent effort to get a major legislative win this year, announcing a long-awaited tax plan that will immediately set off a fight over how much top earners should pay. The framework proposes cutting the top individual rate to 35%, yet leaves it up to Congress to decide whether to create a higher bracket for those at the top of the income scale. The rate on corporations would be set at 20%, down from the current 35%, and businesses would be allowed to immediately write off their capital spending for at least five years. However, the market is mixed on the ability of the White House to pass such critical legislation as the cost of cutting taxes after the destructive hurricanes might hinder the effort for the much anticipated legislation.

On the currency front, the dollar was on its way to record the highest weekly gain in the year. The dollar index started the week at 92.327 reaching all the way to 93.666 but the mixed views of the market on the Trump administration to be effective in pushing the tax reform proposal had the dollar close the week at 93.071.

The Euro lost ground to the bull run of the dollar, opening the week at 1.1909 yet continuously depreciated to reach a low of 1.1718 amid the increasing expectations of an interest rate hike in the US reaching 70% for the December meeting. The single currency closed the week at 1.1812.

The cable traded on a relatively narrow range opening the week at 1.3489. The Sterling lost ground to the dollar rally last week reaching a low of 1.3343, yet the pair was supported by the probability of an interest rate in the November meeting which is at 70%. The currency closed the week at 1.3396.

The Japanese yen opened the week at 112.18, and had a volatile trading week due to the widening divergence of monetary policy between the BOJ and other major central banks. The pair reached a high of 113.25 as comments from the Prime Minister of Japan Shinzo Abe on the status of the Japanese economy drove investors away from the yen. The yen ended the week at 112.47.

Regarding commodities, oil prices are recovering, US storm damage and strengthening economies may have finally dislodged sentiment away from resignation to a future of low oil prices. That's the story, but it isn't the whole picture. And while OPEC and other countries that have cut production will undoubtedly take comfort from Brent near $60 a barrel, they should be wary of taking too much of the credit and certainly can't relax their output restraint. They are not yet out of the woods.

US Housing market

New home sales came at 560K versus the forecasted 585K, a second straight decline in purchases of new US homes and combined with downward revisions for prior months, showed a declining market as results begin to be clouded by the fallout from Hurricanes Harvey and Irma.

GDP Growth on the fastest pace since two years

The US economy grew a bit faster than previously estimated in the second quarter, recording its quickest pace in more than two years, but the momentum probably slowed in the third quarter as Hurricanes Harvey and Irma temporarily curbed activity. Gross domestic product increased at a 3.1 percent annual rate in the April-June period, the Commerce Department said in its third estimate on Thursday. The upward revision from the 3.0 percent rate of growth reported last month reflected a slightly faster pace of inventory investment. Harvey, which struck Texas, has been blamed for much of the decline in retail sales, industrial production, homebuilding and home sales in August. Further weakness is anticipated in September after Irma slammed into Florida early this month. Rebuilding is, however, expected to boost GDP growth in the fourth quarter and in early 2018. Estimates for the growth rate in the July-September period are just above 2.2 percent.

Europe & UK

Draghi on monetary policy and inflation

The ECB President pointed to uncertainties about the medium-term outlook for inflation as he presented an upbeat picture of economic recovery after 17 consecutive quarters of growth and unemployment at the lowest level in eight years. He stressed there was no pre-set size for the central bank’s balance sheet, which depended on the instruments the central bank was using and the state of the economy.

In another speech to the European Parliament's committee on economic affairs in Brussels, Draghi emphasized the need to be "sensitive to the danger of not halting a recovery through hasty monetary-policy decision making." And he warned that any change of monetary policies will maintain “the degree of monetary support that the euro-area economy still needs to complete its transition to a new balanced growth trajectory characterized by sustained conditions of price stability." Nonetheless, Draghi still sounded upbeat and noted that "economic expansion is now firm and broad-based across euro area countries and sectors."

German IFO

German IFO in September came in at 115.2, slightly weaker than the expectations of 116 and lower than August’s 115.9. Both the current conditions and expectations indices declined. The decline, to some extent, is likely to have been impacted by the recent surge in the Euro. Despite the fall in the BCI, it still points to a rise in annual GDP growth from Q2’s level of 2.1%. The annual GDP growth is likely to be around 2.3% this year, the strongest since 2011.

Euro area estimated inflation to be somewhat stable

Euro area annual inflation is expected to be 1.5% in September 2017, stable compared to August 2017, according to a flash estimate from Eurostat, the statistical office of the European Union. Looking at the main components of euro area inflation, energy is expected to have the highest annual rate in September (3.9%, compared with 4.0% in August), followed by food and tobacco (1.9%, compared with 1.4% in August), services (1.5%, compared with 1.6% in August) and non-energy industrial goods (0.5%, stable compared with August).

Carney on Brexit

BoE governor Mark Carney emphasized on the limited power of the policy makers of the central bank to offset any economic hardships caused by Brexit. "The biggest determinants of the UK’s medium-term prosperity will be the country's new relationship with the EU and the reforms it catalysis," he said. As all related stakeholders are awaiting a clearer picture on the direction of the Brexit negotiations, the Sterling Pound is holding its ground at the current level against the dollar.

Asia

Japan's inflation on the rise

National core CPI, the BoJ's core measure, rose 0.7% y/y in August, up 0.2 percentage points from July and in line with consensus. The headline CPI was 0.7% also, constituting a marginal beat, while the ex-fresh food and energy measure rose 0.1% to 0.2%. However, timelier Tokyo figures for September showed less momentum. The core measure rose 0.1% to 0.5% y/y, while the headline and ex-fresh food and energy prints were unchanged from August at 0.5% and 0.0%, respectively. Meanwhile, service producer prices rose 0.2% to 0.8% y/y in August, and corporate goods prices increased 0.3% to 2.9%. Overall, inflation appears to be rebounding nicely.

Kuwait

Kuwaiti Dinar at 0.30185

The USDKWD opened at 0.30185 on Sunday morning.

Rates –1st October, 2017

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.1951	1.1715	1.1960	1.1812	11665	1.1920	1.1880
GBP	1.3491	1.3341	1.3570	1.3396	1.3225	1.3495	1.3450
JPY	111.97	111.46	113.25	112.47	110.95	114.05	111.97
CHF	0.9706	0.9644	0.9769	0.9680	0.9560	0.9860	0.9625