Weekly Money Market Report
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Fed's Tone Limits Yield & Dollar Rise

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Highlights

- **US Dollar gains on risk aversion, Powell's comment limits rise.**
- **Fed reconfirms outlook on loose monetary policy.**
- **New Biden administration to push for further fiscal legislation.**
- **US yield curve steepens to more than 3 year high.**
- **Frail US economic fundamentals support Fed's tone.**
- **Nations across the globe increase COVID restrictions.**
- **GBP best performing major currency thanks to vaccine rollouts and scaling back on negative interest rate.**

United States

Jerome Powell: "Be careful not to exit too early"

The economic calendar was extremely light last week, while the dollar's gain on risk aversion and reflation theme was softened after the Fed's bearish tone on monetary policy reached financial markets. The US dollar has been gaining some upward traction as the latest blue wave seen in Congress and in the White House has increased the chances for additional fiscal injection by the government. Hence, inflation projections, long terms yields and the dollar rose. However, the rise in the greenback softened after the Fed Chairman stated "the US economy is still far from its inflation and employment goals it is too early for the Federal Reserve to discuss changing its monthly bond purchases." "Now is not the time to be talking about exit and a lesson from the Global Financial Crisis is be careful not to exit too early." The Fed's tone pushed the dollar lower and indirectly told market participants not to get ahead of themselves.

President elect Joe Biden has unveiled his new $1.9tn economic rescue plan, setting it up as his highest legislative priority as he prepares to enter the Oval Office on Wednesday. If endorsed by Congress, the package will deliver substantial support to the struggling US economy on top of the $900bn package agreed last month by US lawmakers and $3tn in relief passed at the start of the pandemic. Democrats have now control in the both chambers of Congress after two Democratic Senators won the race in Georgia. Therefore, the blue wave victory across the legislative chambers has increased the probability for Biden's fiscal bill to pass. In details, President Biden's $1.9tn plan includes a new disbursement of $1,400 to most Americans, enhancing the $600 checks recently received by individuals earning less than $75,000 per year. That would bring the total value of recent direct payments to $2,000. There will also be a $350bn injection for budget-strapped state and local governments, $50bn will be set aside for grants to struggling small businesses, a $400bn of new spending to tackle coronavirus and also in the mix is $130bn to accelerate school re-openings across the country.

Looking at US Treasury yields, the 10-year yield has risen as much as 28bps before yields corrected lower, under any context it is a notable move in just seven trading days. Expectations were that the new administration will fund its self through long-term bonds pushed the long-end of the curve higher, while the short-term rates were relatively unchanged. The aforementioned moved caused the 2-10yr yield curve to steepen by 101 points, the highest spread since May 2017. The steeping of the yield curve has had little implications on the dollar because the move higher in 10-year yields has not been driven by Fed policy expectations shifting. The 2-year yield is up only 2bps. This significant steepening of the yield curve limits USD traction. If the whole curve starts to shift then it is a much clearer signal of USD strength.

As for the US dollar, the currency ended the week slightly higher against a basket of currencies after shedding most of gains, pressured by the Fed's dovish comments on monetary policy. Outgoing President Trump's second impeachment is in play at the moment making him the first US president in US history to get impeached twice. The impeachment news had no impact on the dollar or financial markets as a Senate trial is unlikely to go underway before his term ends on January 20. The dollar index was last seen trading at 90.772 and gained only 1.0% in the past five trading days.

Inflationary Data Divergence

US headline inflation figure moved higher last month supported by an 8.4% jump in gasoline prices, which accounted for more than 60% of the rise in the CPI. Data revealed that the US consumer price index rose 0.4% m/m in December, following a 0.2% gain in November. On a yearly basis, the index increased 1.4% following a 1.2% rise in the prior month. On the other hand, core inflation which excludes energy and food items barley edged higher. The core CPI inched up 0.1% m/m. The Fed's main inflation tracker (Core PCE) is currently at 1.4%, way below the 2% average inflation target. The divergence between the monthly inflationary readings suggest that the overall inflationary levels remain weak and that will not motivate monetary policy officials to change their tone. Fed officials are likely to look through any rise in inflation linked to base effects and may even tend to look through any transitory upswing in prices in the latter part of this year.

Frail US Economic Fundamentals

US consumers continued to cut back spending for a third consecutive month in December as renewed measures to slow the spread of COVID-19 intensified. Consumer spending is almost 70% of US GDP, making retail sales a good fundamental indicator. Retail sales fell 0.7% m/m and November's figure was revised lower to -1.4% instead of -1.1% as previously reported. As for the core retail sales, which exclude automobiles, gasoline, building materials and food services tumbled 1.9%. Moreover, the latest Non-farm payroll report revealed that the economy lost jobs last month for the first time since April 2020. Further job losses are likely in January as new applications for unemployment benefits surged in the first week of the month. Overall, the frail economic fundamentals out of the US support the cautiously dovish outlook from the Federal Reserve.

Europe & UK

Vaccine Rollouts & Stance against Negative Rates Pushes Cable Higher

The Sterling pound was the best performing major currency last week with GBP/USD rising to 1.3708, the highest level since April 2018. The pound has been gaining support on two different ends. Bank of England officials scaled back their expectations for negative rates to come. Governor Andrew Bailey said there were "lots of issues" with cutting interest rates below zero, such a move could hurt banks and that it was not easy to draw a direct parallel with similar action in the euro zone. An interest rate cut probability for May decline from around 40% to 19.6%. At the same time, the pound is deriving support from encouraging figures from the UK government over the rollout of vaccines. As of last week, more than 2.6 million vaccines doses have been given to almost 2.3 million individuals. Britain is leading the way amongst major economies in providing vaccines which may well create conditions for a stronger economic recovery later this year. On a weekly basis, the GBP/USD pair has risen around 0.15%, despite incurring heavy losses on Friday due to risk aversion.

The euro on the other hand didn't perform well versus the dollar and has been the second worst performing G10 currency since 6th January. Only the Swedish krona has performed worse. Rising COVID infections and restrictions in euro-zone countries were the culprits in pressuring the EUR/USD pair. The 7-day average of COVID infections across 11 euro-zone countries increased to 109k as of 14th January, close to the highest level since 22nd November. Recent cases in Spain rose to a record on Thursday, more than doubling from Monday, and German infections topped 2 million. Since January 6, EUR/USD is down nearly 1.75%.

Commodities

Oil prices weakened last week pressured by renewed fears on global oil demand due to surging coronavirus cases in China and Europe. China the world's largest oil importer placed lockdowns on four major cities as new COVID cases rose to more than five months high. However, a drawdown in US crude inventories for a fifth straight week and robust oil import data from China capped losses. Crude inventories in the US dropped by 5.8 million barrels last week to around 484.5 million barrels, data from the American Petroleum Institute. On a weekly basis, Brent crude prices fell 2%% or $1.14 a barrel.

Kuwait

Kuwaiti Dinar

USD/KWD closed last week at 0.30305.

Rates – 17th January, 2020

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.2215	1.2225	1.2072	1.2078	1.1980	1.2280	1.2102
GBP	1.3565	1.3709	1.3449	1.3586	1.3480	1.3790	1.3594
JPY	103.88	104.39	103.51	103.87	101.80	105.90	103.77
CHF	0.8849	0.8920	0.8844	0.8907	0.8700	0.9105	0.8883