Treasury Group

Weekly Money Market Report

20 August 2017

Dovish FOMC minutes; members show concern over low inflation

United States

FOMC members split; some call for patience as inflation outlook seems uncertain

Minutes from the Federal Reserve's July policy-setting meeting were released last week as investors awaited more details regarding the Central Bank's plan to move away from its crisis-era stimulus. In particular, economists were looking for hints as to when the Fed will begin taking steps to reduce its tremendous balance sheet size, as the quantitative easing programs have scooped up trillions of dollars of Treasuries and mortgage-backed securities during the financial crisis. Additionally, markets wanted to get a better feel for how many members remain resolved to raise interest rates again this year, and how many are wavering amid a five-month stretch of soft inflation reports.

Regarding the FOMC's views on the federal funds rate, the report stated that "some participants expressed concern about the recent decline in inflation, which had occurred even as resource utilization had tightened, and noted their increased uncertainty about the outlook for inflation. They observed that the Committee could afford to be patient under current circumstances in deciding when to increase the federal funds rate further and argued against additional adjustments until incoming information confirmed that the recent low readings on inflation were not likely to persist and that inflation was more clearly on a path toward the Committee's symmetric 2% objective over the medium term." Meanwhile, investors are still skeptic about a third rate hike before the end of the year, with the current probability standing at 31.2% in terms of market confidence, confirming that it will be a challenging time ahead for the Fed policy-setting committee.

With regards to the timeline of when the Fed intends to starts the unwinding process, the minutes appeared to show that Federal Reserve policy makers were split over the decision. Some members "were prepared to announce a starting date for the [unwind] program at the current meeting", the report said. It also added "most [policymakers] preferred to defer that decision until an upcoming meeting while accumulating additional information on the economic outlook and developments potentially affecting financial markets".

Earlier during last week, US treasury yields enjoyed a mild boost on the back of solid retail sales. However, the yields managed to find their way back down after the release of the dovish FOMC minutes. Even so, political turmoil in the US and abroad garnered demand for safe, low-yielding bonds amongst nervy investors, dropping yields even further. The yield on the benchmark 10-year bond closed the week slightly lower at 2.1940%.

While the Dollar Index opened the week at 93.072, the greenback consistently strengthened throughout the week, and was supported further by strong retail sales data. However, the greenback faced downward pressure when the release of the Fed minutes coincided with US domestic troubles. Still, the Dollar Index managed to close the week higher at 93.434.

The Euro was affected by a number of economic news and events last week. The single currency opened the week at 1.1804 and was mostly stable during the beginning of the week. However, the release of the FOMC minutes strengthened the Euro as the Dollar weakened across the board. Nonetheless, the Euro hit its low of the month as the release of the ECB minutes indicated that policymakers were showing concern with regards to the Euro's strength. Afterwards, the European currency enjoyed a mild recovery as it closed the week at 1.1760.

In the UK, the Pound Sterling weakened against the US Dollar, mainly due to the weaker-than-expected inflation readings. The pair dipped by 0.64% as traders absorbed the news. Positive wage and unemployment indicators did not lift the Pound, as it closed the week lower at 1.2871.

In Japan, the Yen failed to capitalize on strong GDP figures, which indicated that the economy grew at an annualized rate of 4.0%, the 6th straight quarter of expansion led by private consumption and capital expenditure. Even though the reading came in well above expectations of a 2.5% annualized increase, this information has failed to reflect positively on the Japanese Yen which has traded weaker against the US Dollar most of the week. Nevertheless, the Yen managed to gain some ground against the greenback towards the end of the week, where the pair traded near 4 month lows after being triggered by the release of the FOMC minutes, which was viewed as slightly dovish by traders. The pair ended the week higher at 109.17.

On the commodities front, markets witnessed the largest drop in US crude stockpiles in almost a year. Crude oil inventories dropped by 8.9M barrels last week, and are currently at 4.9% below the level a year ago. The drop was more than double the decline forecasted by analysts at 3.1M barrels. However, despite the fall in inventories, which would normally give a strong lift to WTI crude prices, oil futures managed to fall immediately following the release of the EIA report. While oil prices opened the week at $47.59, it closed it slightly higher at $48.59.

US retail sales beat forecasts

United States retail sales figures came in well above market expectations. Whereas economists predicted a 0.4% m/m rise in sales, readings released by the Census Bureau showed that overall sales increased 0.6% from the previous month. Meanwhile, the core retail sales figure, which excludes automobile sales, came in at 0.5% m/m, also above expectations of 0.3% m/m. Even though the positive figures support the case of a third rate hike this year, markets are still skeptic, with the probability of a December hike currently sitting at 31.2% in terms of market confidence.

Europe & UK

ECB policymakers show concern over a strong Euro

European Central Bank policymakers expressed concern regarding the Euro's strength, according to the minutes of the ECB's July minutes. A strong Euro is a hurdle the ECB needs to navigate around as it looks to unwind its quantitative easing program, which will at least continue until December of this year. Recently, the Euro has climbed fiercely, reaching a two-and-a-half year high against the Dollar and rising almost 5% against a basket of currencies since the middle of May. The strength of the single currency hinders the ECB's efforts of reaching its inflation goal of just under 2%, making imports cheaper and weighing on export growth. The minutes attributed the rise of the Euro to the elimination of the political uncertainty following the election of Macron as well as market expectations over US interest rates. Following the report, the Euro fell to its lowest level in three weeks. Nonetheless, it recouped its losses as it rose back to the same level later that day.

UK inflation disappoints

In the United Kingdom, the Consumer Price Index readings disappointed as they indicated inflation was weaker than expected. The official report indicated that consumer prices increased 2.6% in July, less than the 2.7% forecast by economists. The figures took their toll on the British Pound, as it weakened against the Dollar. The Bank of England is facing a challenging time preparing the ground for higher borrowing costs against the backdrop of worsening economic indicators and continued uncertainty about Britain's exit from the European Union.

UK consumers squeezed further

Wages in the UK rose 2.1% year-on-year and continued to lag behind a surge in consumer prices caused by the British Pound's decline after the Brexit vote more than one year ago. Still, wage growth readings came in above expectations of 1.8% y/y, while the prior month's figure was revised up to 1.9% y/y. Per the Office for National Statistics, this leaves real incomes down by 0.5% y/y. Meanwhile, unemployment in the United Kingdom reached 4.4%, its lowest level in 42 years. Unemployment numbers beat forecasts of 4.5%, a match of the prior figure. In a further sign of labor-market tightness, the number of unemployed people per vacancy was at a record low of 1.9.

Irregular UK retail sales point to consumer caution

Shoppers in the UK continued to spend at a rate higher than economists' expectations, as falls in all categories of expenditures were outweighed by higher spending on food, the official report on UK retail sales indicated. A 1.5% m/m increase in the volume spent in "predominantly food stores" managed to prop up the final retail sales figure to a better-than-expected 0.3% m/m, versus expectations of 0.2%. Howard Archer, economist at EY Item Club commented on the contents of the report, saying that "a drop in most sales categories except food points to consumer caution in making discretionary purchases. This fuels suspicion that the pick-up in retail sales in the second quarter was partly a correction to the sharp fall in the first quarter, helped by some warmer weather and the later Easter."

Germany economy extends growth period

In Germany, 2nd quarter growth numbers indicated the German economy grew by 0.6%, marking 3 straight years of growth. While the released number is not as bullish as analyst estimates, the 2nd quarter's growth is in line with the prior figure, which has been revised up to 0.7%. According to Destasis, Germany's federal statistics office, growth was supported by rising domestic demand and investment. However, trade may have held back growth after Germany suffered its worst month for exports in almost two years in June. Nevertheless, the recent solid economic data in Europe's largest economy has helped prop up Angela Merkel—which is eyeing her 4th term as German Chancellor— in the opinion polls ahead of the late September election.

Asia

RBA minutes highlight household debt risk

They Royal Bank of Australia's minutes from its August meeting indicated that the central bank has removed the country's labor market from its watch list. The RBA left rates at record lows this month amid a feeling of confidence that inflation and jobs will pick up. However, the report also added that "members regarded conditions in the housing market and household balance sheets as continuing to warrant careful monitoring" and that the board needed to "balance the risks associated with high household debt in a low-inflation environment" by keeping policy unchanged. The Australian Dollar edged slightly higher immediately following the release of the report.

China's economic growth stalls

Earlier last week, disappointing figures pointed to a second-half slowdown in China's economy. Industrial output readings in China were underwhelming, whereas analysts expected a 7.1% increase y/y, the figure came out at 6.4%. Prior to that, the figure was 7.6% in June. Additionally, retail sales increased 10.4%

y/y, versus a forecast of 10.8% y/y. Furthermore, fixed-asset investment in urban areas rose 8.3% from a year earlier in the first seven months, versus a forecast 8.6% rise.

Japan exports on the rise

In Japan, exports rose for the eighth consecutive month in July after robust shipments to the United States. The recovery in overseas demand from a soft previous quarter underpins a recovering economy. The data underscores the Bank of Japan's view that the world's third-largest economy is showing increasing signs of strength, as private consumption adds momentum to an export-led recovery. Total exports increased 13.4% in July from a year earlier, Ministry of Finance data showed, roughly in line with a median market forecast for a 13.6% gain. The rise, which followed a 9.7% increase in June, was driven by solid auto shipments to the United States and demand from China for electrical equipment.

Kuwait

Kuwaiti Dinar at 0.30185

The USDKWD opened at 0.30185 on Sunday morning.

Rates – 20th August, 2017

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.1804	1.1661	1.1838	1.1760	1.1640	1.1950	1.1822
GBP	1.2992	1.2829	1.3022	1.2871	1.2710	1.2950	1.2920
JPY	109.05	108.58	110.94	109.17	107.30	110.15	108.69
CHF	0.9620	0.9584	0.9765	0.9648	0.9420	0.9840	0.9591