Treasury Group

Weekly Money Market Report

26 March, 2017

Are Investors Too Optimistic?

United States

Markets under Pressure as Trump Faces First Defeat in Office

During the first quarter of 2017, the FOMC raised interest rates while expressing optimism about the outlook of the US economy and signaling continuous gradual rates hikes in 2017. The message was perceived as if the Fed gave the greenlight to extend the risk assets rally based on additional fiscal stimulus hopes, potential higher corporate earnings on the back of falling oil prices despite a stronger US dollar.

Last week, markets start to send different mixed signal under the continued influence of US politics. Indeed, equities, treasury yields and the US dollar dropped reflecting moderating expectations for President Donald Trump's ability to pass meaningful and timely reforms and substantially increase infrastructure spending. Despite the first failure of the President, market implied fed funds probabilities were not heavily affected and continued to price rates hikes over the next six months. The ongoing US economy underlying fundamentals and the hawkish tone that Fed officials began to exhibit in February remain the pillars of the strong dollar we have witnessed in the past three years.

As it became clear that President Trump may not have enough support to pass his first big agenda item; repealing and replacing Obamacare with the American Health Care Act, expectations began to sink and impacted equity markets with the S&P 500 experiencing its worst one day loss in five months by the middle of the week.

Although the president will have time to pass tax reforms, also deem a controversial subject, many more hurdles lie ahead. Additionally, the failure to pass the AHCA has likely the potential to erode the current support for the President and could encourage his opposition to delay or dilute parts of his agenda that have helped drive markets higher. Another key debate on the horizon will be the budget bill. Currently the government is only funded through April 28, and Congress in the US will soon have to address the debt ceiling.

On the monetary policy front, Chicago Federal Reserve President Charles Evans reinforced the perception that the US central bank won't accelerate the pace of its interest rate hikes. However, he added that an additional hike was possible if inflation was to pick-up. In addition, Dallas Fed President Kaplan said Thursday that the Fed should raise interest rates two more times this year and continue working on a plan to gradually reduce its balance sheet.

In Europe, ECB Peter Praet stressed the fact it was premature to consider exiting monetary accommodation. Although he mentioned that things were improving "but the upward trend and hence the normalization of inflation are still very dependent on monetary policy stimulus". He added that "the underlying inflation trend is still noticeably weak" and that there is "more slack than the jobs data show"

Finally in the UK, BoE's Vlieghe said that inflation might not mean a rate increase. Pouring cold water on inflation hawks, he mentioned that the current run-up in inflation is largely due to the weaker GBP suggesting that even if it rose more quickly than expected, it would likely fall more quickly thereafter. It might not have an impact on policy.

On the foreign exchange side, the dollar continues to be affected by the less-hawkish-than expected interest rate hike of last week as well as the failure of President Trump election promises. The dollar index opened the week at 100.370 and quickly fell below the 100 level. The index reached a 7-week low of 99.547 and closed the week at 99.760.

The Euro opened the week at 1.0738 and continued to surge reaching a six-week high of 1.0825 on Tuesday following the EU's statement regarding the UK's exit from the union and support by higher than expected PMI figures. The currency closed the week at 1.0797.

The Sterling Pound had a week of gains even though Prime Minister Theresa May announced the official date for Brexit which will be on the 29 of March. The Pound reached a four weeks high of 1.2530 as inflation figures surpassed BOE's target for the first time in three years. The currency closed the week at 1.2468.

The Japanese Yen also reached a four month highs at 110.60 against the dollar but softened following the less than expected manufacturing PMI figures on Friday. The currency closed the week at 111.33.

On the commodities side, oil prices continued under pressure even with the potential extension of the current OPEC's production cut increased oil prices while a build-up in U.S. crude inventories drove prices down as Brent Crude closed the week at $50.80. Furthermore, gold prices continue to be volatile as investors remain hesitant amid the current political uncertainty.

Durable Goods Increase but Housing Data are Shaky

Orders for U.S. durable goods increased more than forecast in February, a sign companies are confident about the outlook for the economy. Orders for goods meant to last at least three years rose 1.7 percent after a 2.3 percent advance the prior month that was larger than previously estimated, Commerce Department data showed Friday. The median forecast of economists surveyed by Bloomberg called for a 1.4 percent increase. A sixth straight gain in orders for durable goods minus transportation equipment underscores rising demand that will help to broaden economic growth.

US existing home sales stumbled for the month of February. The monthly figure was at 5.48M versus an expectation of 5.59M yet remained above year ago levels, the sales pace is still 5.4 percent more than last year. On the other hand, purchases of new homes increased in February to a seven-month high, indicating the effects of the recent rise in costs on the U.S. residential real estate market have been modest. Sales rose 6.1 percent to a 592,000 annualized pace, Commerce Department data showed Thursday. The median forecast in a survey called for a 564,000 rate. Warmer winter weather probably played a role in boosting demand as purchases in the Midwest surged by the most since October 2012.

Europe & UK

Manufacturing and Services PMI Exceed Expectations

Eurozone economic growth gathered further momentum in March, reaching a near six-year high. The data also saw the best employment growth for almost a decade as both manufacturing and service sector firms responded to surging order books. Business optimism meanwhile hit a new peak, but price pressures also intensified to a near six-year high. The Eurozone PMI rose to 56.7 in March, according to the preliminary 'flash' estimate up from 56.0 in February; the latest reading was the highest since April 2011. The first quarter average of 55.7 is the highest since the first quarter of 2011.
Both service sector and manufacturing input costs and selling prices were found to have been rising at the steepest rates since the first half of 2011 during the first quarter. Growth in Germany increased to the strongest since May 2011, driving job creation to the highest for six years. Output and order book growth accelerated in both manufacturing and services, as did job creation. The German service sector saw jobs being added at a rate not beaten in 20 years of data collection.

UK Inflation on the rise

U.K. inflation accelerated more than economists forecast in February, breaking through the Bank of England's target for the first time in more than three years. The 2.3 percent increase in the consumer prices index was the fastest since September 2013 and above the median prediction for 2.1 percent. The rate is up from just 0.3 percent a year ago, reflecting sterling's 17 percent drop since the Brexit vote in June, as well as an increase in oil prices

The BOE has said it will tolerate inflation overshooting its 2 percent goal as it provides support to the economy, though that stance could be tested if it starts to push up domestic price pressures. One policy maker, Kristin Forbes, broke ranks this month and voted for an interest-rate increase, and some others indicated that they may also be leaning that way.

Asia

Bank of Japan to keep monetary policy in route

Bank of Japan Governor Haruhiko Kuroda said on Friday there is "no reason" to withdraw the bank's massive monetary stimulus now, or raise its bond yield targets, as inflation remains far from its 2 percent goal. Kuroda also dismissed financial market concerns that the BOJ will eventually lose its ability to control long-term interest rates under its yield-curve-control framework. Kuroda added that the BOJ won't increase its bond yield target just because overseas long-term interest rates are rising, a scenario some traders believe is inevitable. The BOJ maintained its short-term interest rate target of minus 0.1 and a pledge to guide the 10-year government bond yield JP10YT at around zero percent after a policy meeting on March 16.

China Financial System Remains Fragile

China's financial system continues to display weakness and liquidity issues. China's seven days repo rate jumped by middle of the week to 5.5%, the highest level since late 2014. PBOC's reacted quickly by injecting RMB 80-90B to the as some small banks failed to repay debts in the interbank market.
Last week, the PBOC raised a range of short-term interest rates to reduce financial risks, thought to be a response to Fed funds rate hike. Interbank rates should remain volatile over the coming week, ahead of PBOC's quarterly assessment in late March.
Although recent data suggested that the problem of capital outflow eased in February, ongoing interest rate normalization in the US would prolong China's capital outflow problem, sustaining the challenges facing China in the implementation of its monetary policy.

Kuwait

Kuwaiti Dinar at 0.30460

The USDKWD opened at 0.30460 on Sunday morning

Rates – 26 March, 2017

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.0741	1.0717	1.0825	1.0796	1.0700	1.0950	1.0845
GBP	1.2387	1.2333	1.2530	1.2470	1.2380	1.2620	1.2502
JPY	112.73	110.60	112.89	111.31	109.80	111.90	110.96
CHF	0.9976	0.9909	1.0002	0.9912	0.9750	0.9970	0.9861