Weekly Money Market Report
19 January 2020

Financial Markets in Risk Taking Mode

>NBK Treasury
+965 22216603
tsd_list@nbk.com

Highlights

- The two largest economies finally sign a Phase One deal, most tariffs still in place.
- Global equity indices rally thanks to improved sentiment.
- FX market barely nudges after trade truce.
- Muted Inflation in the US.
- Sterling pound pressured by rate cut prospect.

United States

US & China Sign "Phase One" Deal

The US and China have finally signed the "Phase One" deal after 18 months of tit-for-tat tariffs that almost plunged the global economy into a recession. Beijing has agreed to elevate its purchases of US goods and services by USD 200 billion over the next two years. In addition, China also agreed for greater financial market access, promised to refrain from devaluing its currency, and protect intellectual property. As a result of China's consensus, the White House canceled a new round of tariffs that were supposed to be implemented last month and lowered the tariff rate on USD 112 billion from 15% to 7.5%.

Despite signs that both sides are willing to play ball, the majority of levies will remain intact until a "Phase Two" deal is concluded and if the US administration believes that China is not living up to its promises, it can easily impose new tariffs on Chinese goods. Overall, the Phase One trade deal has reduced uncertainty around the globe, but a complete resolution between the two nations is far from being resolved. The Phase One deal does not encompass most of the core issues between the two largest economies and it will take time for the second part of the deal to be achieved. Hence, the tariffs theme may persist for a while.

Looking at the equities market, Wall Street registered a trio of record highs last week as all major indices traded in uncharted territories. The signing of the trade truce combined with decent retail sales figures and a positive start to the earnings season paved the way for a rally. As stocks rose, the S&P volatility index declined to a three-week low of 11.75, way below the high of 16.39 seen on January 6. On the other side of the Pacific, Asian shares all cheered with Japan and South Korean shares jumping to 15-month highs.

In the FX sphere, most of the major currencies barely fluctuated after the news reached markets. It seems that the FX market had already priced in the possibility of a trade truce. The most affected pair was the USD/JPY, rising to an 8-month high of 110.28 from 109.77. Since the start of the year, the dollar has gained 1.39% versus its yen counterpart as risks to the global economy diminish. The main winner in the FX market was the Chinese Yuan, appreciating 0.75% on a weekly basis against the USD. Year to date, the CNY has soared by 1.50% against the US dollar.

Inflationary Readings Reinforces the FED's Neutral Stance on Interest Rates

Muted inflationary pressures have puzzled Federal Reserve policymakers who expected that a falling unemployment rate will lift wages and price pressures. However, the aforementioned scenario has failed to come to life. The monthly consumer price index barely rose by 0.2% last month, its weakest reading since September. As for the core reading, which excludes volatile items like food and petrol edged higher by 0.1% m/m. The annual rate for both readings is at 2.3%. The FED's preferred indicator on inflation (Core PCE) has missed its 2% target throughout 2019 and is currently at 1.6%. US wages has been on a decline despite an unemployment rate near a 50-year low of 3.5%. Overall, the FED is concerned that price growth may fall even lower, which supports the FED's neutral outlook on interest rates for 2020. At the same time, financial markets aren't pricing in any significant changes to US interest rates in 2020.

US Consumers Continue to Support the Economy

American consumers ended 2019 on a solid footing, which supported retail sales in the final month of the year. Retail sales increased for a third consecutive month in December and registered a 0.3% m/m reading. Control sales, which ignore items like vehicles, petrol and building materials, soared by 0.5%, the largest surge since July and surpassed expectations for a 0.4% increase. It is evident in the data that US shoppers have been lifting the economy through consumer spending, which accounts for more than two-thirds of US economic activity. However, recent economic figures revealed that consumer spending is losing some momentum after recording a 3.2% annualized rate in Q3. Economists expect that consumer spending will diminish to around 2.5% in Q4, combined with weaker wages seen in the latest labor report may pressure future sales data. In conclusion, the recent sales data are mostly optimistic and is supporting the economy to offset the weaknesses seen in the manufacturing sector.

Europe & UK

Sterling Pound Pressured by Rate Cut Expectations

The Sterling pound's downward trajectory witnessed at the start of the year has gathered further momentum last week as expectations for a rate cut soared. At the commencement of 2020, the UK rate market attached less than a 10% probability for a rate cut on January 30, which is now hovering around 65%. Three MPC members have verbally stated to back a rate cut this month and two more members are needed to seal the deal. Dovish MPC member Gertjan Vlieghe stated that he would vote for a rate cut later this month if key data do not show a bounce in the economy. Likewise, earlier dovish remarks from the BoE Governor and MPC Silvana Tenreyro had already signaled that a rate cut at the end of this month is more than just talk.

Since the Conservative party won the election, the pound has been more influenced by economic fundamentals than it did before. The latest economic readings have been dark indeed. UK's consumer inflation has fallen drastically below the 2% target to a three year low of 1.3%. In November, the economy contracted by 0.3% m/m. On a three-month basis, which reduces volatility in the monthly GDP figures, the economy was 0.9% larger than a year earlier with this growth rate having fallen through the year from 2.2% in March. The last time it was lower was in November 2011. The British economy has been uncomfortably frail which will keep alive prospects for a rate cut and could keep the pound on the defensive in the coming weeks. The most crucial forward looking data will be released on the 24th of January, encompassing the construction, manufacturing and service sectors. The results of the readings will likely dictate the BoE's future stance on interest rates. Year to date, the GBP has lost 1.87% of its value to the US dollar.

Kuwait

Kuwaiti Dinar

USD/KWD opened at 0.30365 on Sunday morning.

Rates –19th January, 2020

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.1114	1.1084	1.1172	1.1089	1.0980	1.1170	1.1157
GBP	1.3043	1.2950	1.3117	1.3006	1.2775	1.3125	1.3056
JPY	109.59	109.54	110.28	110.14	109.15	111.05	109.64
CHF	0.9736	0.9610	0.9736	0.9678	0.9480	0.9765	0.9618