Treasury Group

Weekly Money Market Report

26 November 2017

A soft dollar manages to lose ground against the majors

United States

Fed expresses a slightly dovish tone; Germany faces a period of political uncertainty

Even though the Federal Reserve indicated that it is on track to raise interest rates in December for the third time this year, the Fed's future rate hike path seems uncertain to say the least. Soft inflation figures which, in the past, have been described as "transitory" by Fed policymakers, have cast a shadow of doubt over the central bank's plans to tighten monetary policy. Minutes from the Fed's late October policy-setting meeting indicated that "many participants thought that another increase in the target range for the federal funds rate was likely to be warranted in the near term if incoming information left the medium-term outlook broadly unchanged".

More notably, however, is the fact that while Fed officials remain confident in the labor market and above-trend economic growth, several are looking for stronger signs that price gains will pick up. A few even want to see inflation on an upward path before lifting rates again, underlining a persistent divide on the policy-setting Federal Open Market Committee. Inflation has stubbornly fallen short of the Fed's 2% target for several years, prompting Fed Chair Janet Yellen to say the she is "very uncertain" as to whether inflation will soon rebound toward the Fed's target, and that she is open to the possibility that prices could remain low for years to come.

Inflation is not the only uncertainty following the Federal Reserve. Fed Chair Janet Yellen, as expected, has announced her resignation from the Fed Board and said she will step down from the Board of Governors after new Chairman Jerome Powell is sworn into office. Her departure will leave behind four empty Board of Governors seats out of seven. The unusual pace of the turnover has given Trump the rare opportunity for a president to put his personal stamp on the makeup of the Fed. This is especially true since Fed members have a permanent voting status and make up the majority of the FOMC, the committee in charge of setting interest rate policy. Markets will be keen to find out who Trump appoints, particularly because he has made it known that he favors low interest rates and has been an advocate of looser financial regulations.

In Europe, Germany's September election has set its local political scene for a set of events it rarely faces. The usual mainstream parties have been squeezed by smaller fringe parties, most notably the anti-EU 'Alternative for Germany'. Instead of the usual four or five parties, seven parties are currently represented in an unusually fragmented parliament. As a result, the road to the formation of the new government has been tricky to navigate. Mrs Merkel, the chancellor, and her Christian Democrats party now face three unfavorable options after talks of a coalition government with the Free Democrats (FDP) and the Greens broke down last week. The first is to form a minority government. A minority government would be the first ever in modern Germany, and would require working with other parties on an ad hoc basis in order pass legislation. However, Mrs Merkel has indicated no interest in going down that route, saying that a minority government could not give Germany the stable government it needs. Instead, the Christian Democrats could revive their alliance with the Social Democrats (SPD) as the two parties have governed together since 2013. However, being in government with Mrs Merkel has hurt the SPD, pushing its share of the vote down to its lowest-ever level. This has prompted the SPD to rule out the coalition and favor a stint in opposition to revive itself, even though they would hold more than 50% of votes in parliament together. Finally, the option that remains would be a new election. However, even though the federal president possesses the power to call for a new election, he is reluctant to exercise it. President Steinmeier fears that fringe parties could yield more votes in a new election, destabilizing an already sensitive situation and setting up Germany for something it already possesses enough of, more political uncertainty. This comes at a sensitive time for Europe, where it needs a strong German presence in its ongoing Brexit negotiations as well as on its path to recovery.

On the currency front, the dollar depreciated against a basket of major currencies last week as a string of mixed economic indicators and a slightly dovish Fed failed to impress markets. While the dollar index opened the week at 93.709, it closed it lower at a level of 92.782.

The Euro started the week with a dive as reports out of Germany indicated that coalition talks broke down. However, the single currency managed to bounce back as traders brushed off any worries regarding political uncertainty in

Germany. Boosted by strong PMI figures across the Eurozone towards the end of the week, the EUR managed to rally against a soft dollar as the pair reached a 2-month high of 1.1944 before closing 1.16% higher at 1.1930.

The cable also managed to capitalize on the weakness of the dollar. The pair opened the week at 1.3216 and managed to reach a high of 1.3359 during trading. Later, a rally towards the end of the week saw the pair close at a level of 1.3335, putting the weekly rise at 1%.

The Japanese yen followed a similar trend as it appreciated against the US dollar. The pair dipped to a 2-month low as mixed economic indicators in the US failed to support the dollar. After opening the week at a level of 112.08, the USDJPY pair closed it lower at 111.53.

Regarding commodities, US oil prices soared to 2.5-year highs as North American markets tightened on the partial shutdown of the Keystone pipeline connecting Canadian oilfields with the United States as a result of an oil spill. US light crude surged more than 4% as hit highs of $58.94 per barrel, while benchmark Brent crude reached a weekly high of $63.95. Meanwhile, markets are tightening ahead of an OPEC meeting on November 30, where the oil cuts are expected to be extended beyond the current March expiry. The likelihood of an extension has risen significantly after reports that a deal between OPEC and Russia has been reached.

Mixed US economic indicators

US existing home sales rose 2% m/m in October to a seasonally adjusted annual rate of 5.48 million units, beating market expectations as the impact of Hurricanes started to taper. However, a continuous shortage of houses remains an obstacle that is pushing prices higher. Meanwhile, September's sales pace was revised down to 5.37 million units from the previously reported 5.39 million units.

Also released last week was the core durable goods figure, which measures the change in the total value of new purchase orders placed with manufacturers for durable goods. The figure, a leading indicator of production, unexpectedly fell in October after three straight months of hefty gains, but a sustained increase in shipments pointed to robust business investment and economic momentum as the year winds down.

On the other hand, the American economy's prospects were bolstered by data on Wednesday showing a decline in the number of Americans filing claims for unemployment benefits. Strong business investment and tightening labor market conditions will be used as ammunition should the Federal Reserve stay on track to raise interest rates as planned.

Moreover, the Chicago Fed National Activity Index also beat market expectation and rose to 0.65 in October, up from 0.36 in September. The Chicago Fed index is a composite indicator which includes an average of 85 economic indicators across the United States.

Europe

ECB Minutes

Minutes were released from the European Central Bank's late October meeting where the ECB decided to keep interest rates unchanged at 0% as well as left the door open to extend the quantitative easing program beyond September or raise the purchase amounts if needed. The minutes revealed a divide amongst officials over whether to announce a concrete end-date for QE. Furthermore, officials did not agree to any extension or wind-down phase after September 2018. In fact, some ECB policymakers were opposed to leaving the QE program open-ended, warning that it might lead investors to believe that the program would be extended again. Markets will be looking for signs that QE is ending, since that will signal the beginning of interest rate rises in the Eurozone.

Europe PMI's

Factories across Europe experienced their most productive month since 2011 in September, while the momentum looks set to continue into October as new order growth accelerated. In Germany, economic growth accelerated in November, driven by a pick-up in performance in the manufacturing sector. Meanwhile in France, the increase in output remained broad-based across both the manufacturing and services subsectors. Commenting on the flash PMI data, Chris Williamson, Chief Business Economist at IHS Markit which compiles the report said: “The message from the latest Eurozone PMI is clear: business is booming. Growth kicked higher in November to put the region on course for its best quarter since the start of 2011. The PMI is so far running at a level signaling a 0.8% increase in GDP in the final quarter of 2017, which would round-off the best year for a decade.”

Asia

Reserve Bank of Australia

The Australian Dollar slipped following the release of a cautious monetary-policy meeting minutes from the Reserve Bank of Australia. In their November 7 meeting, the RBA said there was “considerable uncertainty” as to if, and when, subdued wage pressures might lift. Furthermore they warned that consumption growth is likely to be lower in the year’s third quarter. While exports and employment are strong, the heavily indebted Australians need higher wages to spur consumption and raise prices.

Kuwait

Kuwaiti Dinar

The USDKWD opened at 0.30150 on Sunday morning.

Rates – 26th November, 2017

	Previous Week Levels				This Week’s Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.1789	1.1712	1.1944	1.1930	1.1725	1.2095	1.1998
GBP	1.3181	1.3060	1.3259	1.3211	1.3130	1.3540	1.3379
JPY	112.08	111.05	112.72	111.53	109.55	113.50	110.99
CHF	0.9889	0.9784	0.9946	0.9796	0.9615	1.0015	0.9730