Treasury Group

Weekly Money Market Report

27 August, 2017

US Debt Ceiling Looms Over Washington

United States

Dollar Lower After Jackson Hole

There was a sense of uneasiness in financial markets last week after President Donald Trump stated “If we have to close down the government, we are building that wall” causing both the dollar and US equities to fall back while gold moved higher immediately. The Treasury Department stated that the ceiling must be elevated by September 29. If not, the government would be unable to borrow more money to pay its bills, including its debt payments. That could impair the US credit rating, causing financial turmoil.

The cost to protect against a US default over the next five years by purchasing credit-default swaps has risen to about 26 basis points from 20 basis points a month ago. Moreover, the rate on Treasury bills jumped on Thursday in the largest intraday move since March. Furthermore, the rates on Treasury bills maturing in October were higher than those due in September and November. On the ratings front, Moody's Investors Service claimed it would contemplate to strip the US of its top-notch rating in the case of a default, not over late payments on non-debt obligations. Moody’s also claimed chances that the debt ceiling would not be raised in time are "low" despite how contentious it has been recently to achieve a borrowing increase.

On the currency front, the DXY depreciated by 0.61% on Monday, however the downward movement was short lived due to the weakness of the single currency. The greenback entered into positive territory until President Trump’s comments of a government shutdown changed the DXY’s direction. The index opened the week at 93.441. On Friday, the greenback came under pressure as Janet Yellen refrained to comment on the future of the Fed’s monetary stance in the closely watched Jackson Hole Symposium.

The Euro on Tuesday reversed its gains made the previous day after the disappointing German economic confidence pressured the single currency. The EUR/USD rose to a high of 1.1940 and closed the week at 1.1924 as Draghi failed to comment on the Euro’s recent strength fuelling traders to continue buying the single currency.

The Sterling pound took a beating last week and fell to the lowest level since June 27 on Thursday as a reaction to uncertainties related to the UK government’s stance on the Brexit negotiations and disappointing local data. UK growth hit the market with a 0.3% rise, bringing the yearly rate at 1.7%, indicating the nervousness surrounding Brexit. The GBP/USD began the weekly session at 1.2871 and depreciated to a low of 1.2770. The pair ended the week at 1.2887.

Looking at the safe haven yen which was still in demand at the start of the week due to uncertainty stemming from the political crisis surrounding Trump and the potential conflict between North Korea and the US. On Tuesday, the USD/JPY snapped four consecutive days of losing streak as investors risk appetite was slightly improved. After the release of inflation data for Japan’s economy on Friday the yen retreated slightly against its US counterpart during the Asian trading hours. The pair opened the week at 109.39 and closed the week at 109.34.

In the commodities complex, the yellow metal was trading sideways last week and price changes were minimal ahead of the Jackson Hole meeting. Gold opened on Monday at $1,282.60 and ended the week slightly higher at $1,291.03.

Diminishing Housing Demand

New home sales in the US plummeted 9.4% to 571,000 in July, the largest drop in nearly a year as the median price of a new homes increased 6.3% in July from a year ago to $313,700. In contrast, annual wage growth has struggled to break above 2.5%. On the inventory front, new homes on the market expanded by 1.5% to 276,000, the highest level since June 2009. In addition, the price premium for newly built homes compared to existing homes has more than doubled since 2011.

Home resales also followed the downward trend to their lowest monthly level of the year. On a monthly basis existing home sales fell 1.3% to a seasonally adjusted annual rate of 5.44 million. The average price of an existing house was $258,300, a 6.2% rise from one year ago, reflecting the insufficient quantities of properties.

The third-quarter sales figures are starting out significantly below the second-quarter average, and many other housing reports have also shown the same downward trend. The housing market overall is mostly healthy, however sales have fallen this summer due to a lower supply causing prices to rise. The rising prices have made homes too expensive for some buyers, even as healthy hiring has lowered the unemployment rate to a 16-year low at 4.3%. The weak sales pace suggests that the housing sector could remain a drag on economic growth in the third quarter.

A Mixed Bag of Data

Latest manufacturing data from the US indicated a poor start to the third quarter for manufacturers. The index fell slightly from 53.3 to 52.5. The sector was pressured by weakness in exports which declined for the second successive month, although the dollar recent depreciation may start to improve conditions within the next few months.

Looking at the overall composite index which was elevated to a 27 months high in August bolstered some optimism over the American economy. The index rose from 54.6 to 56.0. The flash services index jumped to 56.9, recording its 28 months high, which accounts for almost 80% of US economic activity.

Europe & UK

Worries of a Stronger Euro Currency

The Germany economic confidence decreased for a third consecutive month in August to 10 from 17.5 points. The main factors weighing on the index were weaker exports, ongoing scandals in the automobile industry and concerns that the strengthening euro will dampen export prospects and weigh down on the Eurozone’s largest economy. Monthly exports in July dropped unexpectedly by 2.8% after rising for five consecutive months.

On the other hand, current economic situation in Germany remains robust as did the ZEW President Professor Achim Wambach expressed that overall the country’s economic outlook “remains relatively stable at a fairly high level.” More importantly the preliminary GDP data for Germany in the second quarter increased surprisingly to 2.1% year-on-year, posting the highest growth since August 2016. The assessment of the current economic situation in Germany increased slightly by 0.3 points in August.

The European Momentum Continues

The Eurozone economy maintained its expansionary momentum in the month of August lead by a strong rise in manufacturing production. Services business activity also increased but at a weaker pace. The manufacturing sector outperformed expectations by the best performance in 6.5 years with both output and new orders rising at stronger rates. The components were boosted by exports soaring at the fastest rate since February 2011. The flash manufacturing index increased by 0.8 points to 57.4.

On the other side of the lever, euro zone services activity dipped to 54.9 from 55.4, the weakest in seven months. The service sector growth has been somewhat weaker recently, but the fundamentals for continued strength in the second half of 2017 are still there. Even with a 12% appreciation of the euro so far this year does not appear to have dented manufacturing for now.

Weak Growth in the British Economy

The British economy expanded 0.3% in the second quarter of 2017 as expected by markets. The second quarter figure was an improvement on the 0.2% growth in the first quarter. However, the data still indicates that the British economy is experiencing the slowest growth among the G7 economies. In the second quarter the GDP rose 1.7% on an annual basis. Last month, the IMF stated it predicts the British economy to grow by 1.7% this year, compared with the 2% forecasted in April.

Looking at the components of the GDP, consumer spending, exports and business investment all proved disappointing. Consumer spending growth over the three months slowed to 0.1% down from 0.4%, its worst since the fourth quarter of 2014 as the real income of UK citizens diminishes due to higher inflation. The ONS said the services sector grew by 0.5% in the second quarter from the previous three months, which was the main driver of growth and there was relatively strong growth in government spending.

On the investment front, British business investments posted no growth in the second quarter as uncertainty correlated to Brexit negotiations and June's general election may have weighed on firms' long-term plans. Business investment data appears to be in line with recent surveys that companies are delaying investments as they wait for the cloud of uncertainty to fade away. There was little sign of rebalancing in the second quarter, with both business investment and net trade making no contribution to economic growth.

Asia

Japanese Manufacturing Sector Rebounds in August

Japanese factory output readings signaled that despite the soft figures in June and July, manufacturing activity has managed to rebound as the Japan Flash Manufacturing PMI came in at 52.8 for the month of August from 52.1 in July. The report also showed factory output, new orders and employment all grew at a faster pace than the previous month. Paul Smith, Director at IHS Markit, which compiles the survey commented on the report saying that “Expansion continues to be supported by a mix of strengthened demand from both domestic and external sources. The latest figure provides additional support on the health of Japan’s manufacturing sector.

Can the BoJ Achieve its Inflation Target?

Price growth moderately accelerated in July, largely driven by higher fuel costs, while subdued wage growth discouraged consumers from increasing their spending. Japan's national core consumer prices rose 0.5% in July on an annual basis marking its seventh straight monthly gain. It is a sign the economy is making steady but painfully slow progress toward meeting the central bank's 2% inflation target. Core inflation in Tokyo swelled 0.2% in August coming at 0.4% year to year.

The absence of higher wages even as the jobless rate being at multi-decade lows, should keep underlying price pressures limited in the economy. Moreover, the BoJ has had to push back the timing of its price target six times since it deployed a massive stimulus program in 2013. The bank predicts inflation to reach its 2% target by March 2020, arguing that a tightening job market and solid economic growth will gradually push up prices. Overall, the labor market is tight and business sentiment is high, but wage growth has been tepid and efforts to lift inflation have fallen flat despite years of aggressive monetary easing by Japan's central bank.

A vast majority of firms are opposed to the idea of further radical monetary easing. The data compiled by a Reuters survey showed that Japanese firms believe the central bank's inflation goal will either take more than three years to achieve its 2% goal or is an impossible target. Firms have had to continually cut prices in order to sell more goods, the survey showed. One firm manager wrote: "Under the current circumstances where effective demand is declining, pursuing an ultra-easy monetary policy including negative interest rates hardly produces positive effects. Instead it causes side effects to materialize."

Kuwait

Kuwaiti Dinar at 0.30145

The USDKWD opened at 0.30145 on Sunday morning.

Rates – 27 August, 2017

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.1752	1.1729	1.1940	1.1923	1.1815	1.2110	1.1984
GBP	1.2871	1.2770	1.2916	1.2887	1.2690	1.2965	1.2924
JPY	109.39	108.61	109.84	109.34	107.60	110.10	108.88
CHF	0.9651	0.9549	0.9696	0.9566	0.9380	0.9640	0.9501