Treasury Group
Weekly Money Market Report
17 September 2017

Sterling shines amid BoE hawkish comments

United States

The Fed breathes a sigh of relief as inflation picks up

Last week, the dollar showed signs of a recovery as the easing of nuclear tensions with the defiant North Korean Regime as well as a better than expected scenario regarding hurricane Irma helped lift the dollar against its major rivals. Analysts also attributed the dollar's recovery to comments from Paul Ryan, the speaker of the House of Representatives, in which he said the White House and congressional Republicans would release an outline of their tax overhaul plan by the end of this month. Ryan also stated that the Republicans' goal was to have the tax reforms enacted into law before the end of the year. Meanwhile, Treasury Secretary Steven Mnuchin said Tuesday the Trump administration is considering backdating tax reform to the start of this year to boost the economy. This comes as Trump is searching for solutions with the Democrats in a newfound alliance over tax reform and immigration.

Regarding monetary policy, markets are mixed as to whether the Federal Reserve will go ahead with a third rate hike this year. Recent positive inflation data in addition to a tighter labor market has given the Fed ammunition should it decide to proceed with a December raise. Furthermore, despite the physical devastation of hurricanes Irma and Harvey, the overall economic impairment would not be an obstacle against tightening monetary policy, according to analysts. After all, in 2005 the Fed lifted rates a month after hurricane Katrina, the costliest natural disaster in the history of the United States. Last week saw a rise in uncertainty about a third rate hike this year during the Fed's December meeting, with the probability of a hike reaching 46% in terms of market confidence.

In the UK, the Bank of England prepared the market for a rise, issuing its strongest guidance in a decade that it may be set to raise interest rates. All eyes will be on the Committee's November meeting, which might deliver the BoE's first rate hike since the financial crisis. In the meantime, whilst the Monetary Policy Committee members voted 7-2 against an increase in rates, "a majority of MPC members judge that, if the economy continues to follow a path consistent with the prospect of a continued erosion of slack and a gradual rise in underlying inflationary pressure then, with the further lessening in the trade-off that this would imply, some withdrawal of monetary stimulus is likely to be appropriate over the coming months in order to return inflation sustainably to target. All members agree that any prospective increases in the Bank Rate would be expected to be at a gradual pace and to a limited extent." Even though analysts expected a hawkish BoE meeting outcome, the committee's statements were regarded as much stronger than expected. The probability of a rate hike reached 64% in terms of market confidence. The meeting's effect on the Pound was considerable, where the GBP immediately strengthened against the dollar by 120 points as traders reacted to what could be the first rate hike in 10 years for the central bank. Commenting a day after the BoE meeting, policymaker Gertjan Vlieghe reiterated that "If these data trends of reducing slack, rising pay pressure, strengthening household spending and robust global growth continue, the appropriate time for a rise in the Bank Rate might be as early as in the coming months". Vlieghe's comments boosted the GBP to a level of 1.36 for the first time since the Brexit vote.

The Sterling pound started the week off at a stable level until the release of the inflation numbers, which came in strong and managed to lift the cable. However, these gains were wiped off on Wednesday, after wage figures failed to pick up again. Nevertheless, the cable saw fresh 14 month highs on Thursday thanks to the overly hawkish tone of the BoE. The cable opened the week at 1.3202, it ended it at 1.3591.

The Euro had somewhat of a quiet week, mainly reacting to movements in other currencies. It weakened against the dollar as the latter gained some ground across the board. The single currency also dropped against the British pound after the BoE issued its hawkish statements. The EURUSD pair opened the week at 1.2039, and closed it at 1.1941.

The Japanese yen opened the week at 108.19, and continued to consistently lose ground to the dollar. This was the result of easing tensions around North Korea's nuclear program, as the yen is often viewed as a safe-haven in times of uncertainty. Towards the end of the week, a North Korean missile that flew over Japan failed to rattle markets as traders continued to sell the yen. The USDJPY closed the week at 110.84.

Regarding commodities, oil prices saw a rise this week after the International Energy Agency announced that global oil demand will climb this year by the most since 2015, mostly due to increased demand growth from both Europe and the United States. The IEA raised its estimate for demand growth in 2017 by 100,000 barrels a day to 1.6 million a day, or 1.7%. Meanwhile, US crude oil inventories rose by 5.9M barrels and product inventories such as gasoline and distillates fell sharply as a result of Hurricane Harvey, which prompted Texas oil companies in the affected area to temporarily close down their refinery operations. Additionally, OPEC is discussing extending the oil production cuts which are due to expire in March 2018.

US Inflation

Positive US CPI figures were released last week after 5 months of disappointing numbers. The consumer prices index rose by 0.4% from the previous month, and 1.9% y/y. The higher inflation was assisted by a jump in the cost of housing in addition to higher gasoline prices. Additionally, core CPI, which measures inflation but leaves out food and energy costs increased by 0.2%, in line with the market forecast after 5 months of weakness. Meanwhile, the producer prices index missed the estimate again. The report, released by the Bureau of Labor Statistics, showed that producer prices increased 0.2% higher in August against a consensus of 0.3%. The overall inflation data increased uncertainty regarding a December hike.

US Retail Sales

US retail sales came in lower than expected as overall sales fell 0.2% m/m. Industrial output recorded its biggest drop since 2009 at 0.9% as Hurricane Harvey disrupted activity, suggesting the storm might hinder economic growth in the third quarter. July's figure was revised down to 0.3% m/m from 0.6% and June's sales were also revised lower to a 0.1% m/m drop, down from a 0.3% gain. Notably, motor vehicle sales fell 1.6% m/m, the biggest drop since January. Moreover, core retail sales rose 0.2% m/m, below analysts' estimates of a 0.5% increase. According to analysts, the weak retail sales and industrial output reports will probably do little to change expectations that the Federal Reserve will announce a plan to start shrinking its $4.2 trillion portfolio of Treasury bonds and mortgage-backed securities at its September meeting. However, the latest results make it more likely that consumption, the biggest part of the economy, will be hard-pressed to match the 3.3% growth pace of the prior quarter.

Europe & UK

UK Inflation

The consumer prices index figure came in stronger than expected. The figure, released by the Office for National Statistics, indicated that consumer prices rose 2.9% y/y, whereas analysts expected 2.8%. Increases in fuel prices as well as clothing helped lift the index to the highest in five years. In addition, other indices from the United Kingdom have also exceeded expectations. The producer price index (PPI) was released at 1.6%, the highest in 7 months. While the retail prices index (RPI) came in at 3.9%, the highest level since March of 2012.

UK Wages

Meanwhile, wage rises in Britain have failed to keep up with inflation again despite a robust labor market that saw unemployment fall to its lowest level since 1975. Average annual earnings increased by 2.1% in the three months to July compared with a 2.6% increase in inflation in July that left workers suffering a 0.4% fall in purchasing power. The squeeze on wages continues to be a challenge the BoE must face, as the falling unemployment has failed to spark wage growth. The pound dropped 1.33% from its high against the USD after the release.

UK Unemployment

The United Kingdom's unemployment rate continued to fall to new lows. Whereas analysts expected the rate to remain the same at 4.4%, the official figure signaled that the rate has dropped to 4.3% for the period of May to July, exceeding analyst's expectation of 4.4%. The rate set a fresh record as the lowest in 42 years.

Asia

Australia Employment

Employment figures in Australia flourished in August, coming in well above analysts' expectations where 54K jobs were added. The number was the highest in 5 months, exceeding expectations by about 37K while the y/y pace jumped to 2.7%, the best since 2015. Meanwhile, unemployment rate was unchanged for the third straight month whereas the participation rate rose to 65.3%. However, even though the labor market is showing progress this needs to translate into wages growth for the RBA to proceed with a hike in the near term. In addition, RBA board member Ian Harper said last week that the economy is yet to grow strongly enough to justify a rate hike, citing under-employment, wages, and income growth as obstacles.

China Economy

Earlier last week, disappointing figures indicated further cooling in China's economy. Industrial output readings in China were underwhelming, whereas analysts expected a 6.6% increase y/y, the figure came out at 6%. Prior to that, the figure was 6.4% in July. Additionally, retail sales increased 10.1% y/y, versus a forecast of 10.5% y/y. Furthermore, fixed-asset investment in urban areas rose at the lowest level since 1999, at 7.8% from a year earlier in the first eight months.

Kuwait

Kuwaiti Dinar at 0.30130

The USDKWD opened at 0.30130 on Sunday morning.

Rates – 17th September, 2017

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.2039	1.1836	1.2039	1.1941	1.1850	1.2130	1.2005
GBP	1.3202	1.3158	1.3615	1.3591	1.3480	1.3780	1.3630
JPY	108.19	108.12	111.32	110.84	108.75	111.75	110.35
CHF	0.9465	0.9463	0.9700	0.9597	0.9385	0.9690	0.9540