Treasury Group

Weekly Money Market Report

18 February 2018

Dollar Tumbles Despite Rising Yields

United States

Demand for Safe Havens Intensifies

Markets are struggling to comprehend the recent feebleness of the Dollar in a period of rising Treasury yields and a massive fiscal stimulus injected in the American economy. Inflation expectations have risen across the board and the FED's tone indicates no hesitation in tightening its monetary stance. So what could the factors driving the US dollar into continuous negative territory be? The logical answers would be the US budget deficit, trade protectionism, politics in Washington, and hawkish central banks around the globe.

Looking at the national debt, which hovers around $20.6 trillion and accounts to 105% of GDP, it is estimated to grow to 150% of GDP by 2047 according to a study done by the Congressional Budget Office. The latest tax cuts and the budget plan that elevated spending limits by $300 billion over the next two years. Coupled with rising interest rates, this poses a great risk to the US, especially if the economy takes a downturn in the future as we have witnessed in the years 2000 and 2008.

As for Trump's approval rating, there has been a rise from 38% calculated two months ago to nearly 43.5% last week. The rise is mainly attributed to the passage of the tax cut. These numbers will convey to the President that if you follow through on election campaign promises it benefits your approval rating. Trade protectionism was one of the main themes during Trump's campaigning, so it is likely that this will now be the focus of policy direction in the coming months as the mid-term election takes place this year.

BoE policy makers have tuned their interest rate expectations upward. The ECB is anticipated to end its bond buying program this year and hike interest rates in early 2019. However, the BoJ seems dovish about changing its monetary stance especially with the reappointment of Governor Kurodo. Interestingly, the Japanese yen and Swiss franc have been the top two performers among G10 currencies on YTD basis. The reason is that demand for safe haven assets are on the rise due to market volatility. Higher Treasury yields caused a sell-off in the equity and bond markets. It seems investors are waiting for yields to climb further before they reinvest in the above markets.

On the currency front, last week the US dollar index declined substantially to the lowest level since December 2014. Rising US Treasury yields were overshadowed by negative sentiment. The DXY began its weekly session at 90.129 and closed at 89.100. The index lost 1.14% of its value last week.

It was a light week in terms of economic data for the single currency and the euro didn't hesitate to take advantage of the Dollar's weakness. The EUR/USD appreciated to 1.2555, the highest level witnessed since December 2014. The euro gained 1.24% versus the dollar last week.

In regards to the Sterling pound, the GBP/USD found support at the start of the week after BoE policy makers sounded hawkish on interest rates. The Sterling rose to 1.4144 versus the greenback on Friday, an 11-day high. Some of the gains were lost after UK retail sales came below expectations. The GBP/USD ended last week's session at 1.4040.

Safe haven assets (JPY, CHF and gold) have been in demand lately as investors sought shelter after the recent spike in markets volatility and uncertainty about US politics. The yen soared to a 15 month high, while the CHF appreciated to the highest level since June 2015 versus the Dollar. The yellow metal was elevated near one month high and closed at $1,347.77 on Friday.

Inflation Figures Pave the Way for Higher Interest rates

Inflation in America surprised markets to the upside last month as the headline and core figures surpassed estimates. Headline CPI rose 0.5% while the core index rose 0.3%. On a yearly basis headline CPI was steady at 2.1% as the core rate persisted at 1.8%. Energy prices surged 3.0% in January, with a 5.7% increase in gasoline prices while clothing prices rose by 1.7%. Even after the strong rise in wages seen in January, the increase in CPI has come a lot earlier than many had anticipated even before fiscal stimulus measures and increased government spending have had any meaningful impact on the economy. This sets the stage for an interest rate hike by the Federal Reserve in March. The Fed Funds market indicates that investors now widely expect the US central bank to raise interest rates at least three times this year. The latest data supports the theme that a new era of reflation has emerged after years of subdued price growth.

On the producer front, price growth also found support from the energy sector. The headline and core PPI both rose 0.4% from the previous month. Compared to a year ago, producer prices were up by 2.7% in January, reflecting a slight increase from the 2.6% in December, while core data declined slightly last month to 2.2% from 2.3%. Whole sale inflation may find further upward assistance moving forward due to Dollar weakness and President Trump’s trade agenda.

Retail Sales Disappoint for two Consecutive Months

Consumers in the US cut back purchases on motor vehicles, furniture and other products in January, which pressured retail sales into negative territory of -0.3% m/m. The recent softness in the last two readings was larger than expected and could trim overall growth forecasts for the current quarter. Looking backwards, spending in 2017 was robust, enhanced by a drop in the average savings rate. The fresh dip in retail spending could be the start of a cutback on the part of consumers as they attempt to bring the average rate of saving back up. Overall consumer spending has decent support looking forward, especially since tax cuts will lift disposable income. However, after the speedy rise in expenditure during the second half of 2017, the first half of 2018 may witness a more moderate pace of spending.

Europe & UK

EU GDP at 10 Years High

The 28 members of the EU experienced the strongest expansion in a decade last year. The single economy grew 2.5% annually and 0.6% in Q4 2017. As for Europe’s core economy, Germany recorded a full-year growth of 2.2%, the highest since 2011 according to the country's Federal Statistics Office. Growth was motivated by solid investment and exports, although private consumption eased a little from previous quarters. Looking at internal factors, domestic demand was horizontal in Germany during the last quarter. Even with the low unemployment rate, tight labor market and signs of upward wages momentum, hopes were high for German consumers to finally start to do the heavy lifting in terms euro-area growth. In regards to monetary policy, QE seems to be coming to an end this year and the recent appreciation of the euro poses a bit of a headache for the ECB.

High Inflation Shows no Sign of Cool Down

The persistence of high CPI in Britain supports the case that inflation is unlikely to fall back quickly and may take several years before the BoE feels comfortable with the inflation levels. The latest readings on consumer and wage inflation reinforce the case for borrowing rates to head north in order to tame the overshooting price growth. Markets expect a 70% probability of a quarter-point rise in interest rates by May, and a roughly 50% chance of a further increase in rates to 1% by year end.

Last week’s print presented little news to the MPC, who predicted January inflation of 3% on an annual basis. The BoE’s strategy depends on the expectation that continuous strength in the labor market could create excess demand in the economy, which in turn should push up domestically-generated inflation. For that reason, the MPC appeared to broadly endorse market expectations for around three further rate increases over the next three years.

In details, consumer price growth remained constant at 3% versus an expectation of a dip to 2.9% by markets, while the core data increased by 0.2% to 2.7%. The core CPI was enhanced as the price for services rose to 2.8%, compared with the previous reading of 2.5%. With wages gaining momentum, we could expect higher core figures because the cost of services are thought to be more sensitive to changes in the cost of labor, while the prices of goods are more dependent on the exchange rate.

Lately, policy makers at the BoE have adjusted their dovish tone thanks to a worldwide economic recovery and indications of a pick-up in Britain's wage growth. British citizens behavior was another factor for the hawkish outlook on interest rates as their willingness to borrow demonstrated that the economy is ready for somewhat higher borrowing costs. Former dovish member Vlieghe stated that the willingness of UK residents to borrow implies that at current interest rates they no longer want to ease debt burdens. Numerous members of the MPC have said they expect rates to rise again after the Bank maintained its monetary stance at their last meeting. The question has now moved from when it will hike to the pace of further tightening. Even with all the recent optimism emerging lately, uncertainty looms over the UK about the correct equilibrium level for interest rates, and that would depend on the economic impact of Britain's departure from the EU in March 2019.

Asia

Japan's GDP Figure Supports the Case for Loose Monetary Policy

The Japanese economy continued its expansion in the last quarter of 2017, but the rate of growth has slowed down significantly. The preliminary GDP reading came in at 0.5% annually, lower than the forecasted 0.9%. Quarter on quarter GDP rose 0.1%, slowing from the 0.3% increase in the third quarter. Nevertheless, the economy still performed strongly last year as whole when it expanded by 1.6% which was the fastest calendar year of growth since 2010. The perseverance in Japan's growth is due to strong global demand that assisted Japanese manufacturers, and kept the jobless rate below 3%. However, on the wages side no upward momentum was witnessed. The leisureliest economic growth in nearly two years (0.1%) and an appreciated yen that stands at 15 months high, highlights the ongoing struggle to revive inflation even as prices elsewhere in the developed world begin to inch higher. The decline in momentum suggests that the economy is still some way from being self-sustaining, and will likely mean that monetary policy will remain on hold for a considerable period longer.

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Kuwait

Kuwaiti Dinar at 0.29940
The USDKWD opened at 0.29940 on Sunday morning.

Rates – 18 February, 2018

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.2252	1.2233	1.2555	1.2404	1.2205	1.2605	1.2487
GBP	1.3826	1.3794	1.4144	1.4040	1.3835	1.4240	1.4084
JPY	108.84	105.52	108.84	106.30	104.35	107.30	105.71
CHF	0.9401	0.9186	0.9402	0.9276	0.9075	0.9485	0.9212