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Weekly Money Market Report
16 September 2018

Risk Appetite Resurfaces

United States

Dollar Falls on Improved Market Sentiment

An invitation for trade negotiations by the White House was extended to China for renewed dialogues, which has paved the way for risk taking in the market. The news comes as US inflation (CPI & PPI) disappointed expectations, pressuring the Buck into a downward movement, while supporting US equity indices. Emerging market currencies also performed well like the South African rand and the Mexican peso. The MSCI Emerging Market Currency Index rose 0.65% over the past week. Further risk taking usually suggests a move out of safe haven assets like the yen, dollar and gold.

As for Turkey, the lira has appreciated by more than 4% in the last five trading days and broke the 6.00 support level versus the US dollar. The last time USDTRY moved below the 6.00 level was in August 27. The upward movement in the Turkish currency was after the central bank of Turkey raised the one-week repo rate by 625 points to 24%. Equities in Istanbul also rallied, with the BIST 100 index up 1.1% and banking shares rose 4.2% after the decision to increase the cost of funding. The CBoT also calmed market sentiment by stating it would continue to use all available instruments in pursuit of price stability and that a tight monetary policy would be retained until inflation exhibited significant improvement.

Last week's monetary action by the CBoT was clearly an encouraging development. The central bank has acted in a more orthodox manner that could assist investors' confidence in the Turkish market. The perception of the CBoT's policy independence has also been strengthened as policy action followed further criticism from President Erdogan just before today's policy meeting. Nevertheless, Erdogan's constant disapproval is likely to remain a concern and questions the sustainability of the CBoT's tighter policy stance especially if it fails to have the desired effect. Renewed trade negations between the two largest economies and the greenback's recent deprecation may have opened a short-term window for high beta emerging and commodity currencies to stage a rally after being hit hard by a heavy sell off in recent months. Market risks in Turkey are still high and the previous aggressive tightening of monetary policy in Q2 brought only a momentary period of stability for the lira. Price momentum in Turkey increased sharply to 17.9% in August and markets perception is for a further rise beyond 20% before year end.

US Inflation Disappoints to the Downside

US consumer inflation in August inflated at a slower pace than predicted by markets, dragged down by healthcare and apparel expenses. The annual headline CPI shrank from 2.9% towards 2.7% and the core figure also shifted lower to 2.2% from 2.4%. Producers' price growth also disappointed markets as the figure entered into negative territory for the first time in 18 months. The PPI dropped to -0.1% m/m, pinning down the annual rate to 2.8% from 3.3%

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In spite of last week's softer readings, inflationary forces are steadily building up, driven by a tightening labor market and robust economic growth. For example, the FED's preferred indicator, the core PCE in July reached the target set by the central bank. Wage growth as well is moving in the right direction, which is currently at nine years high. Combine that with rising oil prices and the number of US citizens filing for unemployment benefits dropped to a near 49-year low. Money markets are currently pricing an 80% probability of two further interest rate increases this year by the FED; a month ago the number was hovering around 60%. The overall picture portraits an optimistic view on the American economy, while other developed nations struggle to achieve their inflation target.

On the currency front, the US dollar index lost its momentum of appreciation last week and the index sunk to the lowest level since July 31. The DXY fell around 0.5% last week, and is currently trading below its 100-day moving average for the first time since the end of April. Risk appetite is gaining ground due to a restart of China-US negotiations. It seems that the current administration is under heavy pressure from businesses to prevent any further escalations in trade disputes as the midterm election is around the corner. Economic indicators out of the US also did not favor a stronger USD.

UK & Europe

ECB in Autopilot Mode

The EU's central bank preserved its monetary direction last week to end the purchases of government bonds and other assets by year end, but left the door open to change its mind if necessary. The ECB pledged to shrink the EUR 30 billion purchases of monetary stimulus assets to 15 billion in October as markets expected. Draghi's tone on inflation and wage growth was optimistic. The price growth forecasts remained unchanged for 2018 till 2020 at 1.7%, while stating that uncertainty on inflation is receding. Draghi also concentrated on healthy domestic fundamentals, encompassing strong growth in employment and salaries, which are anticipated to elevate inflation higher, even if only slowly. Since 2013, the European block created 9.2 million jobs.

On the negative side, the ECB believes that the single economy will expand at a pace of 2.0% this year and 1.8% in 2019, a touch lower than its previous forecast of 2.1% and 1.9% respectively. The ECB's head also acknowledged that risks from emerging markets in China, Turkey and Argentina were intensifying and said trade tensions were also concerning. It seems policy setters consider the recent turbulence in emerging markets, Brexit and the trade war theme will not be enough to derail an economic expansion now in its sixth year. The monetary meeting indicated that the ECB remains in autopilot mode and a rise in interest rate is not expected till the end of summer 2019.

The single currency took advantage of the dollar's weakness and rose to 1.1721 on Friday, the highest level since August 28. The euro also found further support on Draghi's optimistic tone towards inflation. EUR/USD began the week at 1.1553, ended the weekly session at 1.1628.

BoE Maintains Interest Rate as Expected

Policy setters at the BoE unanimously decided to retain the GBP 435 billion quantitative easing program and maintained its interest rate at the current level of 0.75% as markets have predicated. The central bank cited that greater uncertainty has risen on the Brexit front due to rising prospect of a no deal with the EU. The statement was backed by surveys, which suggested 40% of individuals expect leaving the EU to reduce exports. On the other hand, only 14% were planning for higher exports. The survey also showed corporate heads have underestimated a slowdown in sales and that this weakening was likely to persist.

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The Bank's regional staff also informed that companies were tightening cost control and holding off on investment ahead of UK's March 2019 withdrawal from the EU. Even so, the BoE elevated their estimate for Q3 growth to 0.5% from 0.4%, thanks to higher consumer spending over an unusually warm summer.

In the next two months, intensive talks are on the way between Britain and the EU to tackle out details of the divorce deal, while some of Theresa May's own lawmakers intensely attack her preferred compromise deal. The BoE's MPC promised to remain with the ongoing tightening of monetary strategy at a gentle pace so long as there was a smooth Brexit. The majority of economists polled by Reuters do not anticipate the Bank to hike again until after Britain has left the EU. Hence, the reaction of households and business towards Brexit are important factors in determining the path of monetary policy.

UK Wages Improve

Employees in the British economy experienced an uphill surprise on the salaries front as wages excluding bonuses rose from 2.7% to 2.9% 3m/yr in July. In the same time, salaries including bonuses were elevated to 2.6% from 2.4% 3m/yr. The decent figures propose that there is still life in the British economy in the face of negative market sentiment and pressures faced by the household sector. Looking at the employment numbers, the unemployment rate remained at 4.0% after having declined from 4.2% in the three months to June. That represents a 43-year low. However, employment growth slowed from 42k to 3k in the three months to July, the slowest rate since last October.

The rise in wages could be interpreted as the normal rules of economics are kicking in. The unemployment rate is at a 43-year low, suggesting organizations are raising wages in order to retain new employees from the labor market. In economic terms, the Phillips curve could be affirming itself and that domestically generated inflation will build from here. The slowdown in employment growth might be consistent with this view. On the other hand, markets have previously witnessed those levels before, earlier this year and back in 2015, only to ease back again. The mode of uncertainty due to Brexit still persists over the economy combined with the recent slowdown in growth across Europe. It may be doubtful whether wage growth will start to make noteworthy gains towards its pre-crisis average rate of around 4% per year.

The British Economy Rebounds

Economic growth in Britain surprised to the upside in the three months to July and the 0.6% quarterly figure was the best reading in almost a year. The latest GDP number is far from reassuring markets that UK's economy has recovered from Brexit uncertainties. Once again the dominant service sector supported the upward momentum in GDP, while the industrial sector fell back from the higher previous readings. Services industries grew by 0.6% in the three months to July, while retail trade grew by 2.1% and wholesale trade by 1.6%. On the other hand, annualized growth in industrial production eased to 0.9% from 1.1%. Similarly, manufacturing output progress shrank to 1.1% from 1.5%.

In regards to the sharp rise in retail sales, consumers are beginning to spend more freely as the squeeze on real wages finally eases off. The data also pointed out that much of the expenditures were on food and beverages powered by the World Cup and other summer events. Overall, the manufacturing sector persists in a fragile state, with the rolling three-month growth negative for the fifth month in a row. The improvement in GDP backs the BoE's case that the weak readings in Q1 were due to harsh weather conditions. Some business are still suspending investment plans as the terms on which Britain leaves the EU on March 29 continue to remain blurred, posing the risk of disruption to existing trade activities.

Looking at the Sterling pound, the cable has rebounded following last month's heavy sell off and was the best performing currency last week, appreciating by nearly 1.1%. GBP/USD is trading above its 55-day moving average for the first time since April, which provides a bullish technical signal for the pound. Once again the GBP was supported sharply on the back of recent positive Brexit headlines. Chief Brexit negotiator Michel Barnier expressed optimism that a deal could be reached in the coming months and that the withdrawal agreement is 90% complete. Furthermore, positive development for the pound came from

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positive UK economic data such as GDP and wage growth. GBPUSD opened on Monday At 1.2926 and closed on Friday at 1.3066.

Asia

Japan's Growth Elevated by Capital Expenditure

Japan's economy expanded at the fastest pace in more than two years after the Cabinet Office publicized an annualized rate of 3% for Q2, versus an initial reading of 1.9%. In quarterly terms, GDP grew 0.7%, up from the previous estimate of 0.5%. The economy was driven by heavy capital spending in the wake of trade tensions and a string of natural disasters. The capital expenditure has been the bright spot for the economy. On the other hand, companies are refraining from sharing additional profits with employees, creating an environment of subdued consumption and inflationary data. The latest takan survey revealed that there's a solid appetite for business investment. As such, capex may remain in an uptrend to support the economy in the road ahead. The survey showed corporate capex increased at the fastest pace in 11 years in Q2.

Uncertainty over exports still looms over the economy as president Trump's latest comments was directed towards Japan, while China shows no hesitation of backing down against the US tariffs. Overall, the strong trend in capex contrasts the continuous decline in private consumption and swelling trade tensions between the US and China loom as risks.

The Japanese yen followed the US dollar lower as risk appetite improved globally. Emerging market's currencies rebounded as trade tension diminished and Turkey's central bank hiked interest rates significantly. The Japanese yen was one of the worst performers last week. Even with a weakening USD, the dollar managed to gain 0.96% versus the JPY in the last five trading days.

Kuwait

Kuwaiti Dinar at 0.30280

The USDKWD closed at 0.30280 on Sunday.

Rates – 16 September, 2018

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	High	Low	Close	Minimum	Maximum	Forward
EUR	1.1553	1.1721	1.1524	1.1628	1.1425	1.1830	1.1715
GBP	1.2924	1.3142	1.2895	1.3066	1.2865	1.3275	1.3124
JPY	110.97	110.84	112.16	112.04	110.10	114.35	111.34
CHF	0.9688	0.9759	0.9632	0.9673	0.9485	0.9875	0.9600

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