Treasury Group
Weekly Money Market Report
19 February 2017

At least, Three Seats will be Vacant by April

United States

March Hike Consideration

Now that Fed Chair Yellen's tenure is coming close to an end, the market is likely to start shifting its focus on her potential replacement. In addition, coming April, there will be three vacancies on the board of governors of the Federal Reserve and given the fact that the republicans have the congress and the senate, it is likely to be an easy task for the President to appoint people close to his agenda.

This week, Yellen faced tense criticism during her testimony in front of the House of Representatives, mainly from lawmakers who viewed that low interest rates and buying large amounts of bonds from the market in response to the last financial crisis led to the slowest U.S. economic recovery since the Second World War. Although, Yellen defended the FED's policy by claiming the FED used the appropriate tools to rescue the economy from disaster, she admitted the recovery hasn't been at par.

Yellen elaborated that economic growth in the U.S. continues to accelerate with inflation edging higher and the labor market remains near full employment. She added that waiting too long to hike rates will eventually lead to a faster pace of tightening, causing financial instability and increase the chance of a recession.
During the second day of testimony, Yellen said "Unemployment has come down substantially and we're quite close to achieving our labor market objectives, but slow productivity growth hasn't helped." Moreover she asserted "the economic growth performance has been quite disappointing," a point she agrees on with the president.

On the currency front, the US dollar index started the week in positive territory and reached a high of 101.76 on Wednesday due to the robust economic data and Yellen's hawkish comments on the first day of the congressional testimony. However, the bullish momentum was short lived as Yellen's second day of testimony was less hawkish after she stated that economic growth has been quite disappointing. The index opened the week at 100.95 and ended the week 100.95.

The EURUSD was on a down trend at the start of the week on worries over political uncertainties in Europe. However, on Wednesday the euro started to reverse its losses after the dollar dipped. The single currency opened the week at 1.0630 against the dollar and reached a low of 1.0520. On Friday, the EURUSD pair closed at 1.0611.

The USDJPY appreciated for a short period on Monday after the Japan-US summit ended smoothly in Washington and President Trump did not talk about the Yen's devaluation. The pair then jumped on Tuesday after Yellen's Hawkish comments and rose to a high of 114.95 on Wednesday. The bullish momentum did not last for long and continued its decline until Friday. The pair started the weekly session at 113.63 and ended at 112.85.

In the commodities space, gold opened the week at $1,231 and depreciated after President Trump spoke about tax cuts reaching the market fairly quickly. On Wednesday the price of gold fell to a one week low at $1,216, however the drop was short lived after the dollar backed away from its upward momentum closing the week at $1,235.

Oil was particularly volatile this week as the market took crude prices as high at $53.59, before tumbling to $52.68 on Friday, and then reverse again into the close to actually finish up +0.60% at around $53.36. A combination of growing US inventories following the latest EIA data and a news report suggesting that OPEC could look to extend the six-month production cut both seemed to play their part

Despite the Political chaos, the US is likely to Deliver Strong Growth

The latest data from the Philadelphia Fed indicate that manufacturing activity continues to expand after falling over the last couple of years by depressed energy investment and weak global demand. The February Philadelphia Fed manufacturing index jumped 19.7 points to 43.3, the largest one-month gain since June 2009. The figure is now at its highest level since January 1984 at 47.0. More importantly, the details of the survey showed an improvement that point to an ongoing increase in business spending this year. New orders came at 38.0 against expectations of 26.0 and shipments at 28.6 versus 20.5. In addition, one of most observed series within the Philadelphia Fed survey, the six-month outlook for capital expenditures, remained elevated in February. The broader pickup in manufacturing sentiment bodes well for business spending, which has been extremely depressed over the past year. Looking at historical patterns, in 1984 when the Philly Fed index was around the 44 level, the GDP growth was at 7.3%. Based on the historical relationship, the data would point to a GDP growth of at least 6% for this year.

Retail sales as well continue to expand for a fifth consecutive month even though inflation soared near four years high. US retail sales came in at 0.4% on a monthly basis, well above market expectations of 0.1% and compared to January last year retail sales were up 5.6%. The jump in retail sales is mainly due to the purchases of electronics and appliances, which advanced 1.6% in January, the most since June 2015. Consumer spending accounts for as much as 70% of US economic growth, reinforcing optimism that consumer spending will be able to push economic growth at the beginning of 2017.

Last but not least, U.S. inflation rose for a third consecutive month due to surge in prices for clothing, new vehicles, gasoline and other commodities. The consumer price index jumped 0.6% in January from the previous month of 0.3%, the largest gain since February 2013. Last month's data placed the yearly CPI at 2.5%, the biggest year on year gain since March 2012. Core CPI also increased slightly by 0.1% to 0.3% on a monthly basis and to 2.3% from January 2016.
On the wholesale level, prices recorded their biggest jump in more than four years. The producer price index for final demand jumped by 0.3% to 0.6% last month as half of the gain is attributed to a 12.9% surge in gasoline prices. Despite the month to month gain, the PPI only increased by 1.6% on a yearly basis.

In summary, the strong data along with the up trending inflation at a three year high have brought the Fed close to the target of 2% inflation with full employment. This is why, looking now at the dot plot, the Fed has more ammunition to move faster into a tightening mode in 2017.

Europe & UK

Higher Growth Anticipated in Europe Despite the ECB's Dovishness

The main event in the Euro zone this week was the publication of the latest ECB meeting minutes which confirmed that the ECB's underlying message remains unchanged. The dovish stance was evident with the ECB remaining reluctant to consider any unwinding of its quantitative easing program.
Despite acknowledging that the downside risks to growth have receded somewhat recently, the broad consensus continues to be that scaling back the stimulus could be negative as it could undermine the incipient recovery.
Nevertheless, if the recovery in the EMU continues on the back of a strong global growth, the tone of the central bank should potentially turn more hawkish in 2017.

Despite the ongoing political uncertainties, the Euro zone economic recovery is expected to advance at higher rate in 2017 and 2018 than previously anticipated by the European Commission. Looking at future prospects, the European Commission predicts Eurozone GDP growth of 1.6% in 2017 and 1.8% in 2018. The latest data is slightly revised up from the previous forecast of 1.5% in 2017 and 1.7% in 2018.
According to the report, the recovery in Europe is positively correlated to the growth expectations in developed economies outside the EU, which have improved in recent months. The improvement of anticipated growth in developed nations is largely due to the expectations of a fiscal stimulus in the United States.

Greece…Again?

During the past week, Greece has returned as a concern for markets. The second review of its third €86 billion bailout has run into roadblocks which need to be cleared ahead of large debt redemptions in mid-July. The second review is also when the IMF has to decide whether it wants to participate in the program. This all will require difficult compromises between Greece and its European creditors, and potentially the IMF – each of which are under pressure from stakeholders. In details, Greece is facing heavy redemptions in July of EUR 6.5 billion due to the ECB, IMF, and from maturing bonds, in addition to a EUR 2 billion redemption in Treasury bills.
The worry remains that without new tranches of financing from the second program review, the government would not be able to cover the redemptions in July.

UK's Economy Struggling between Rising Inflation and Falling Wages

UK retail sales continued to fall after a drop in December. These numbers display evidence that consumption is weakening, having defied economists' expectations by remaining so resilient in the months after the EU referendum. Consumers may be displaying a delayed response to the post-referendum uncertainty. Alternatively the rise in input costs and prices following the fall in GBP during the last eight months may be finally starting to bite. Either way, retail sales growth is now at its lowest since 2013.

Moreover, inflation reached the highest level since June 2014, as the consumer price index year on year rose from 1.6% in December to 1.8% in January versus a forecast of 1.9%. The higher inflation is attributed to a jump in energy prices, which is up by almost 88% from last year and a weaker currency since the vote to leave the European Union.

The data on UK's labor market showed real wage growth fell to a two-year low towards the end of 2016 as earnings growth declined by 0.2% quarterly to 2.6%. On the other hand, employment hit a new high of 74.6% in Q4 2016, while the unemployment rate remained at an 11 year low of 4.8%.

On the monetary front, speculation on monetary tightening has increased since inflation has accelerate for four consecutive months and the Bank expects inflation will rise above 2.7% in a year time as Brexit pushes cost of imports higher. However, the BoE expects wage growth to fall further to 2.2% in 2017. In summary, the central bank may not be able to raise interest rates until wage growth picks up and as UK's economy adjusts through Brexit uncertainties.

Asia

China's Inflation Hits more than a 2 Year High

China's consumer price index soared in January to a level not seen since June 2014 due to rising energy prices and higher demand for food during the Lunar New Year festival. The CPI index year to year accelerated from 2.1% in December to 2.5% for January versus a forecast of 2.4%. However, the rise in inflation may be short lived as the increase in food demand is a seasonal appetite.

On the producer front, the producer price index continues its upward momentum since September 2015. The index climbed 6.9% in January from a year earlier and 1.4% month to month, this sets the PPI to the largest rise since 2011. The boost is attributed to a rebound in commodity prices including iron ore and oil. In details, mining products surged 31% year on year while those for raw materials climbed 12.9%. In conclusion, the continuous rise in PPI is elevating global inflation as the world's largest exporter transfers the bill to its clients after emerging from years of deflation.

Continuous Growth in Japan's Economy

The Japanese economy continues to expand for a straight fourth quarter, a streak not seen in three years led by solid exports and firmer capital expenditure. The Latest data shows that overseas demand now accounts for about half of the expansion in gross domestic product, leaving the economy particularly exposed to any new trade barriers from the U.S., which is Japan's biggest export market after China.

On a quarterly basis, the economy grew 0.2% in the fourth quarter versus a forecast of 0.3%, placing the yearly growth at 1% and also missing an expected growth of 1.1%. In conclusion, the strength in exports that has supported economic growth indicates how important it is for Prime Minister Shinzo Abe to ease trade tensions with the Trump administration.

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Kuwait

Kuwaiti Dinar at 0.30525

The USDKWD opened at 0.30525 on Sunday morning.

Rates – 19 February, 2017

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.0630	1.0520	1.0680	1.0611	1.0450	1.0825	1.0661
GBP	1.2488	1.2379	1.2548	1.2412	1.2250	1.2635	1.2448
JPY	113.63	112.58	114.95	112.85	110.45	113.85	112.48
CHF	1.0028	0.9959	1.0118	1.0025	0.9860	1.0195	0.9978