

Weekly Money Market Report

15 July 2018

The Dollar Rallies on Escalating Tensions in Europe and Solid Inflation Data

United States

Trade tensions are still very well in place between the US and China. After the 25% tariff on \$50bn of Chinese imports -of which \$34bn of goods is already being charged- the Trump administration is forging more aggressively into a trade conflict with China. Their latest action, which will impose a 10% tariff on \$200bn worth of Chinese imports later this year, effectively functions as a \$20bn tax increase. In addition to the \$12.5bn on the original \$50bn tariffs, the tally will reach a total of \$32.5bn in taxes.

The earlier round of tariffs was geared toward machinery components and electronics, while the second round includes items such as luggage, tires, baseball gloves and apparel. Most of the mentioned can come from outside China at competitive prices, and for this reason the impulse will be muted by other producers, both domestic and external filling the gap. This also means that the \$32.5bn price tag is an overstated number.

The current magnitude of trade tensions is unfamiliar territory in the modern era, and the lack of precedent is leaving forecasters unsure on how to estimate the cumulative impact of the situation. One way to look at the situation is to reframe the tariffs as a moderate tax increase or any other familiar economic development to have a useful but rough point of comparison. The \$32.5bn effective tax from the tariffs is essentially equivalent to a sustained 33 cent increase in retail price of gasoline in the US which currently stands at near \$2.85 per gallon. Adding the 33 cent increase would bring the gallon closer to \$3.20, this price was withstood by the US economy from early 2011 through late 2014. With its current growth trajectory that is sturdier, and thanks to lower unemployment and the recent tax cuts, the US economy is certainly able to endure a development similar to the gasoline price increase mentioned earlier. Another angle that should be looked at, is that the implied tax hike from the aforementioned tariffs is dwarfed by the roughly \$170bn price tag of this year's tax reforms.

China on the other hand is promising not to stand still. The People's Republic of China's Foreign Ministry spokesperson Hua Chunying said in a regular briefing that "US behavior is a typical trade bullying". And that China will make the "necessary counter-measures and resolutely safeguard its legitimate rights and interests" and reiterated "We don't want a trade war, but we are not afraid to fight". She promised that the Ministry of Commerce will handle the details of retaliation measures. The Chinese Ministry of Commerce said that it will file a complaint to the World Trade Organization against the actions of the US, while pledging to make "necessary counter measures" and call on the international community to defend against "trade hegemonism."

On Thursday, the Trump administration came under fire from both parties in the Congress, as legislators expressed intensifying concern about the economic damage that could result from a trade war with America's key partners. There was a rare bipartisan harmony between senior republicans and democrats while hammering the administration. They showed their worries over the risks to the US economy as Donald Trump pursues trade actions against China and close US allies including Canada, Mexico and the European Union.

Turbulent NATO Summit

Donald Trump's visit to Europe during the past week was eventful to say the least. He started his trip with the two-day NATO summit that was overshadowed by him. The US president hit out his country's allies, signaling out Germany for criticism. According to Trump, his anger towards Berlin and other NATO members is coming from what he sees as inadequate defense spending, large goods surpluses with the US and in the case of Germany, plans to increase gas imports from Russia. On his final meeting of the NATO summit, President Donald Trump rounded on his fellow leaders giving them a tongue-lashing. He emerged from the meeting claiming they had agreed to "substantially up" their defense spending.

That assertion by Trump was rapidly contradicted by French President Emmanuel Macron and Italy's Prime Minister Conte, while the German Chancellor Angela Merkel only gave a vague assurance that her country needed to do more.

The European leaders had expected a less contentious second day of talks given the fact that Trump agreed to a statement on the first day. The statement was that each country needed to spend 2% of their GDP on defense. This certainly was not the case, it reached a state where the NATO Secretary-General Jens Stoltenberg shifted the meeting into an emergency session, where only NATO leaders and one other official from each country remained. "He listed their sins," said one person who described the meeting as chaotic.

After the meeting, Trump held an impromptu press conference where he said: "I told people that I would be very unhappy if they didn't up their commitments very substantially... and countries are going to start upping their commitments". As soon as Trump departed the summit, some of the other leaders had suggested that the alliance only agreed to "redouble" their efforts to boost spending without making any commitments. Macron described the meeting as a "moment of truth" about burden sharing, but dismissed suggestions that the allies had agreed to go beyond the 2% goal. Merkel acknowledged that there was a need to look into the issue and address it, while still indicating that there had been no additional spending commitment.

The Greenback went up on a one way street increasing by 1.37% at the highest and reaching 95.24, it ended the week at 94.806.

Solid US Inflation Data

Inflation in the US reached its highest level in 6.5 years in the year through June. Headline CPI showed prices were 2.9% higher last month compared to the same period last year, with CPI increasing 0.1% in June. Core CPI, which excludes volatile food and energy prices also ticked up to 2.3% from 2.2% bringing it to an 18 month high.

The numbers do support the case for future interest rate increases from the Fed. They also helped push the yield on the policy sensitive 2-year Treasury note higher, further reducing the gap between it and 10-year yield.

UK & Europe

Brexit development Dictate the Cable

The UK started the week with the resignation of key members of Theresa May's government. Brexit Secretary David Davis and his deputy Steve Baker resigned late on Sunday and were followed by the Foreign Secretary Boris Johnson. Their resignation comes after May finally won an agreement for her Brexit plans from her cabinet on Friday. The "Chequers Plan" that was agreed upon would keep the UK effectively in the EU Customs Union and the single market for goods, but not services.

On Thursday, the UK's Brexit white paper was released. The white paper is a 98-page document that is meant to accelerate negotiations in Brussels so as to clinch a Brexit deal by autumn.

Britain wants an "association agreement" with the EU of unprecedented breadth and depth, with access tailored to UK interests. Cross-border trade in goods and agricultural products would continue unimpeded, with Britain largely applying the EU's rule book. And as far as most service industries, Britain is seeking continuity of EU market access under different legal structures. With a treaty-based system to manage different UK and EU industry rule books, that are supposed to lead to the same outcomes.

Earlier today in an interview with the Sun newspaper, President Donald Trump said talking about the Brexit deal "if they do a deal like that, we would be dealing with the European union instead of dealing with the UK, so it will probably kill the deal" meaning a trade deal between the US and the UK. He then added "I would have done it much differently. I actually told Theresa May how to do it, but she didn't listen to me".

A few hours later, Trump appeared with May in a press conference where he said he looked forward to finishing a post-Brexit trade deal with Britain, marking an abrupt change from the newspaper interview. Trump had mentioned in the conference that May was doing a "fantastic job", and the decision on what to do once the Brexit process finishes is up to the UK and whatever they do is ok with him. He actually insisted on them to make sure that they trade together. May praised the UK's relationship with the US, she spoke of the importance of the "special relationship", saying that it is something that Brexit supporters hope will reap benefits when Britain leaves the EU, allowing it to forge closer trade ties with the world's biggest economy.

The Sterling started the week with a downward movement dropping by 1.65% at the lowest; it has finally started to gain ground due to the press conference held between Trump and May. The Cable closed the week at 1.3232.

UK GDP on the right track

In the UK, GDP growth is gaining ground on a monthly basis. As mentioned by the Office for National Statistics, warmer weather and the royal wedding in May had helped Britain bounce back from zero growth in March, the time when stormy weather caused the economy to flatline. GDP increased by 0.3% in May up from 0.2% in April. The ONS said that the average growth for the three months ending in May was 0.2%.

Draghi Bullish Speech

In a meeting with the European parliament, ECB's Mario Draghi delivered a bullish assessment of the Eurozone's economic prospects. He said that the Policymakers aggressive monetary easing, including the landmark quantitative easing program, has been "very effective" and will boost growth and inflation by 1.9 percentage points between 2016 and 2020. Draghi did however point out that they needed to be patient, persistent and prudent in their policy to insure that inflation remains on a sustained adjustment path.

Asia

Kuroda on the Japanese economy

Bank of Japan's Governor Haruhiko Kuroda maintained his optimism despite a recent downswing in business sentiment. On Monday, Mr. Kuroda said that the Japanese economy is expected to continue its moderate expansion. While suggesting that he is not in a hurry to take further monetary easing measures, he reiterated his commitment to keeping ultra-easy monetary policy until inflation reaches the BOJ's 2 percent target. "Japan's economy is moderately expanding as a positive cyclical mechanism operates from income to spending," he said at a meeting of the BOJ's regional branch managers.

Kuwait

Kuwaiti Dinar

USDKWD opened at 0.30270 on Sunday morning.

Rates – 15th July, 2018

Currencies	Previous Week Levels				This Week's Expected Range		3-Month
	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.1622	1.1619	1.688	1.1685	1.1485	1.1785	1.1765
GBP	1.3127	1.3118	1.3239	1.3232	1.3030	1.3340	1.3286
JPY	112.60	112.28	112.64	112.36	111.35	114.30	111.66
CHF	1.0058	1.0016	1.0068	1.0016	0.9915	1.0210	0.9940