Treasury Group

Weekly Money Market Report

05 November 2017

US Dollar Maintains Strength in a Highly Eventful Week

United States

Three Central Bank Meetings

Last week the market revolved around three major central bank meetings and the monthly US employment report. The Bank of Japan held the first meeting in which it left policies unchanged as expected. With an 8-1 vote and lower inflation forecasts for this year and next, the Bank effectively signaled that monetary policy will probably remain expansionary for some time longer than most major central banks.

The FOMC meeting was held next where it also left interest rates unchanged while pointing out solid economic growth and a strengthening labor market despite the impact of recent hurricanes. Indeed, while below expectations, the US added 261,000 jobs in October reinforcing the Federal Reserve's assessment. The report indicated that the Fed is on track for another hike in December. Although bond yields declined slightly over the week, market expectations for a December hike are now at 90%.

In related news, President Donald Trump has nominated Board Governor Jerome Powell as Fed chairman to succeed Janet Yellen in February 2018. Powell, 64, a lawyer and investment banker has worked alongside Yellen for the past five years and backed her direction on monetary policy. He also shared her concerns that weak inflation justified a continued cautious approach to raising interest rates. It is therefore expected that the transition will run smoothly with little changes to current Fed policies.

Finally, the main event of the week was the Bank of England who followed through with their first interest rate hike in ten years. The quarter of a percent increase puts rates back at last year's pre-Brexit vote level of 0.5%. While the hike was anticipated, the big disappointment came with the slow path of tightening hinted to follow over the next few years. Markets fear that with inflation in the UK overshooting the BoE's target of 2% now close to 3%, more aggressive policies are required to combat the appreciation of prices. However, the bank believes that a slower more cautious approach is required as the UK prepares to leave the European Union. Furthermore, the bank expects the recovery in global demand should diminish the effects rising import prices on inflation.

In the currency markets, the US dollar maintained its gains made last week after the dovish European Central Bank meeting. Most developments over the week favored a stronger dollar over other majors. Solid manufacturing and employment economic figure released Friday saw the US dollar index close the week at a high of 94.917.

The British pound had the worst performance this week dropping around 1.6% against the USD after the Bank of England meeting. Even optimistic manufacturing and services data weren't enough to stop the fall. The GBP/USD opened the week at 94.834 and closed at 94.941.

The Japanese yen initially appreciated after the Bank of Japan meeting early in the week but eventually gave in to the USD strength. The divergence in monetary policies between the US and Japan and the yen's role as a funding currency also aided in the rise in USD/JPY. The pair opened the week at 113.72 and close at 114.06.

In the oil markets, oil prices are recovering as global demand increases and economic growth in China and the US pick up. In a statement, Saudi Crown Prince Mohammed bin Salman said that demand was even strong enough to absorb the increase in shale oil production. Furthermore, OPEC and non-OPEC producers will meet later this month to discuss the future of oil policy. It is expected that the supply curb in place will be extended beyond March 2018. Benchmark Brent crude was up around 2.25% in the week to a close of 62.07.

FOMC

The Federal Reserve kept interest rates unchanged on Wednesday and pointed to solid US economic growth and a strengthening labor market while playing down the impact of recent hurricanes, a sign it is on track to lift borrowing costs again in December. "The labor market has continued to strengthen and economic activity has been rising at a solid rate despite hurricane-related disruptions," the committee said in a statement after its unanimous policy decision.

Personal Spending Rebound

In the US, personal spending jumped to 1.0% reflecting a strong rebound after last month's 0.1% increase. The increased spending in September was broad-based across both goods and services. Much of the gain was concentrated on autos and auto parts as hurricane damage lead to replacement vehicle purchases. As a result, September's robust pace of consumer spending is probably unsustainable. A sharp jump in gasoline prices also lead to higher spending. Consumer spending accounts for more than two-thirds of US economic activity.

Consumer Confidence High

Consumer confidence increased to its highest level in almost 17 years in October boosted by a consistently healthy labor market. Consumers were also considerably more upbeat about the short-term outlook, with the prospect of improving business conditions as the primary driver. Confidence remains high among consumers, and their expectations suggest the economy will continue expanding at a solid pace for the remainder of the year.

US Employment

The US economy added 261,000 jobs in October rebounding from September's hurricane disrupted reading of 18,000. The gain was the largest since July 2016 as 106,000 leisure and hospitality workers returned to work. While being below expectations of 310,000 jobs the number is still very optimistic and supportive of a Fed rate hike. Wages on the other hand, were flat at close to 0% in part due to the return of the lower-paid industry workers that were left out of last month's reading. Year on year the increase in wages are now measured at 2.4% down from last months inflated reading of 2.9%.

Europe & UK

Bank of England

The Bank of England's Monetary Policy Committee unanimously hiked rates for the first time in ten years by 0.25% to 0.50%. This reverses the emergency cut made in August 2016 after the Brexit vote. Although the hike came as expected, the path of tightening was revealed to remain slow with two more hikes expected by 2020. With regards to the BoE's asset purchasing program, it was left unchanged.

While forecasting sluggish GDP and consumption growth over the next few years, the Bank expects that the recovery in global demand and the depreciation of the pound should help net trade recover. Moreover, the effects of rising import prices on inflation is expected to diminish over the next few years, and domestic inflationary pressures gradually pick up as spare capacity is absorbed and wage growth recovers. The rapid rise in inflation after the Brexit vote is expected to peak above 3% in October before gradually falling back towards the 2% target as conditioned by future rate hikes.

Finally, the BoE's Inflation report highlighted the noticeable impact the decision to leave the European Union is having on the economy. The depreciation of the pound and resulting overshoot of inflation and the growth of Brexit uncertainties that are weighed on domestic activity, which has slowed even as global growth has risen significantly. The report also revealed that monetary policy cannot prevent the effects of the adjustments needed for the United

Kingdom to move towards its new international trading arrangements or the weaker real income growth that is likely to accompany that adjustment over the next few years. The Monetary Committee will continue to monitor closely the incoming developments, including the impact of the interest rate hike, and stands ready to respond to changes in the economic outlook to ensure a sustainable return of inflation to the 2% target.

UK Industry Surveys

The UK manufacturing sector continued to expand in October with production and new order volumes rising at robust rates. Companies benefited from improving domestic market conditions and rising inflows of new export business. The seasonally adjusted IHS Markit/CIPS Manufacturing Purchasing Managers' Index registered 56.3 in October, up from 56.0 in September.

The UK construction sector rebounded slightly from a contraction last month due to a solid increase in residential building work. The survey however signaled that business conditions remained subdued in October due to lack of civil engineering and commercial activity. Brexit related uncertainties have continued to discourage commercial clients while civil engineering firms are running out of big ticket infrastructure projects to replace completed contracts. The seasonally adjusted IHS Markit/CIPS UK Construction Purchasing Managers' Index registered 50.8 in October, up from 48.1 in September.

The UK services sector expanded at the fastest since April, supported by improved order books and resilient client demand. Survey respondents noted that a rebound in new order growth from September's 13-month low had helped to lift business activity during October. However, the rate of job creation slipped to a seven-month low due to increased Brexit related worries about business investment among clients. The seasonally adjusted IHS Markit/CIPS UK Services Purchasing Managers' Index registered 55.6 in October, up from 53.6 in September.

Eurozone GDP Expands

Economic growth in the euro area came in ahead of expectations in the third quarter with the latest monthly unemployment figures also beating estimates in a mixed set of data releases. Preliminary Eurozone GDP rose 0.6% in the third quarter from the previous one, data from Eurostat showed on Tuesday. That is down slightly from the upwardly-revised 0.7% quarter-on-quarter growth in the second quarter but ahead of a consensus estimate of 0.5%. The euro area unemployment rate also dropped below 9% for the first time in 8 years to 8%.

Asia

Bank of Japan

The Bank of Japan left its main monetary policy tools unchanged last week. The policy rate was kept at -0.1%, the 10-year JGB yield target was left at 0.0%, and the asset purchases were maintained. With an 8-1 vote and the BoJ lowering its inflation forecasts for this year and next, the Bank effectively signaled that monetary policy will probably remain expansionary for some time longer than major central banks. Such divergence in monetary policy is expected to weigh on the Japanese yen exchange rate over time.

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Kuwait

Kuwaiti Dinar at 0.30275
The USDKWD opened at 0.30275 on Sunday.

Rates – 05 November, 2017

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	High	Low	Close	Minimum	Maximum	Forward
EUR	1.1601	1.1690	1.1592	1.1607	1.1415	1.1725	1.1673
GBP	1.3111	1.3319	1.3037	1.3074	1.2870	1.3185	1.3114
JPY	113.72	114.42	112.95	114.06	113.00	116.15	113.52
CHF	0.9974	1.0037	0.9936	1.0005	0.9925	1.0205	0.9941