Weekly Money Market Report
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Trade Tensions Re-emerge

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Highlights

- President Trump elevated the tariffs rate from 10% to 25% on $200 billion worth of Chinese imports.
- US inflation data supports the FED's neutral stance on interest rates.
- Safe haven assets outperformed (JPY & CHF appreciate).
- UK annual GDP rebounds to almost a two-year high.
- Reserve Bank of Australia maintains its cash rate.

United States

Demand for Safety Assets is on the Rise

Economic indicators released last week were minimal, hence markets' attention was directed towards the ongoing trade negotiations between the two largest economies. Risk aversion was the dominant theme throughout the week even before the trade war rhetoric resurfaced on Friday. President Trump elevated the tariffs rate from 10% to 25% on $200 billion worth of Chinese imports. In addition, Trump threatened to go even further by imposing 25% levies on all imports from China. On the other side, Beijing stated it would retaliate even as the two sides pursue a last minute meeting to salvage a trade deal. China's Commerce Ministry said it deeply regrets the US decision, adding that it would take necessary countermeasures, without elaborating. It seems that months of easing trade tensions have dissipated, paving the way for safety assets to outperform.

Looking at the best performers in the FX market last week, the safe haven Japanese yen soared to a 3-month high of 109.46 and gained nearly 0.80% over the US dollar. The Swiss franc was the second strongest, rising by 0.46%. Euro displayed a lot of resilience appreciating around 0.35% versus the USD. What is worth mentioning is that the US dollar usually trades in positive territory during times of risk aversion. However, last week this wasn't the case. The DXY depreciated by around 0.23% in the past five trading sessions. It appears that mounting fears of an escalation in the trade war theme could force US policymakers to cut interest rates. If China retaliates then the threat of a global trade war will affect the outlook of the US economy. In this case, the FED has more room to ease than most other central banks. The implied probability from the FED Funds futures for the US central bank to lower interest rates by 0.25% this year is around 40%.

As for the equities market, volatility was more evident compared to the FX market. Wall Street's favored volatility indicator spiked last week to 23.38, the highest level since early January. At the start of the weekly session, the volatility index was around 12.80. US stock markets performed poorly and the green zone was nowhere to be seen as investors rushed to safety assets. In weekly terms, the Dow Jones was down by 2.12% and a 2.18% loss for the S&P 500 was registered.

In the bond market, demand for US government bonds soared due to the risk aversion theme overshadowing financial markets. Bond prices rose, pushing long dated yields lower. Markets witnessed a slight inversion of the yield curve when the 10-year yield on Thursday fell by 6 basis points to below the 3-month yield. The curve was briefly inverted for a short period of time, although the gap has since then shifted back to above zero. On the other side of the Atlantic, the German 10-year government bond yield sank and was headed to its largest weekly fall in seven weeks on Friday.

Inflation Data Supports the FED's Neutral Stance on Interest rates

US annual wholesale prices remained unchanged in April for both the PPI and core data. The PPI is currently at 2.2% and the core index, which strips out volatile food and energy prices, remained at 2.4%. The aforementioned numbers have debilitated even as oil prices recovered. The PPI was at 3.4% in summer of 2018, while the core PPI hovered around 2.9% at the end of 2018. As for the consumer inflation, the CPI came in at 2% last week, way below the 2.9% recorded in July 2018. Price growth has been losing momentum and the FED's preferred indicator of overall inflation grew at the slowest pace in 14 months. The US central bank is trying to achieve a price stability of 2% and has failed to attain its target as the core PCE index was last recorded at 1.6%. Price pressures have remained moderate despite a strong economy and tightening labor market. Hence, the FED's hesitation towards elevating its overnight rate makes sense, especially with the global economy cooling down.

Europe

Euro-zone PMIs' on a Downward Path

The single economy continues to lose momentum at the start of the second quarter, pressured by the manufacturing sector that is in its steepest downturn since 2013. The Composite PMI, which combines the manufacturing and service sectors dipped to 51.5 in April. The manufacturing sector has been in a contractionary mode the past three months as the PMI figures came in below the 50 threshold. As for the service sector, it remains somewhat more resilient. The service PMI figure is currently at 52.8, down from 53.3 seen in March. The sector persists on contributing positively to GDP thanks to its expansionary status of above 50. However, the reading has weakened significantly since the start of the year from around 57. Hence, the above figures do support the ECB's view that no rate hikes are planned before the spring of 2020 and this dovish tone has made the euro less attractive. Year-to-date, the euro is down by nearly 2% versus the dollar.

UK GDP Rebounds

The British economy rebounded in Q1 2019 to 0.5% q/q from a previous reading of 0.2% q/q. On an annual basis, the economy experienced the strongest rate of growth since Q3 2017 as GDP grew by 1.8% y/y. The fact that the UK succeeded in expanding faster than the Eurozone growth of 0.4% q/q is at first glance, impressive. However, most of the positive contribution is attributed to factories rushing to complete orders before a Brexit that never came. A 2.2% increase in factory output was seen in the first quarter and marking the sector's biggest contribution to overall economic growth in nearly 20 years. In regards to other economic indicators, the services PMI came in only just above 50, the consumer sentiment resides near a six-year low and housing prices remain in a soft state. Overall, the economy got a sharp one-off boost due to Brexit stockpiling and the BoE expects growth in the second quarter to return to a lackluster figure of 0.2%.

Asia

Chinese Inflation Rises

Both consumer and producer prices inflated last month on the back of an increase in food inflation and higher oil prices respectively. The annual CPI rate expanded to a six-month high of 2.5% from 2.3%. However, the rise is mainly attributed to a 14.4% y/y jump in pork prices. China's farming industry has been hit with the African swine fever and forecasts are revealing that the disease will leave 130m fewer pigs in China by end of year, limiting the supply of the country's preferred protein. Looking at producer inflation, the figure rose to 0.9% y/y its fastest pace of growth in 2019, from 0.1% y/y. Inflationary figures seem to be improving since the downfall in late 2018. However, this shouldn't be interpreted as evidence of stronger domestic demand. Price growth was mainly driven by supply-side disruptions and not by demand-pull inflation, where aggregate demand in an economy outpaces aggregate supply.

China's Resilient Service Sector

China's service sector displayed a slight improvement last month as the Caixin Services PMI edged up by 0.1 point to 54.5. The aforementioned figure registered the highest reading since January 2018 on the back of solid expansion in exports. The PMI survey revealed that growth in new export orders received by Chinese services entities expanded at its quickest rate since Caixin measurements began. Services PMIs'

(NBS & Caixin) indicate a resilient service sector thanks to a sustained recovery in domestic demand, which account for more than half of China's economy. Therefore, the resilient service sector could assist to counter any volatility in the country's manufacturing sector that has weakened since the trade war rhetoric arose. Job creation in the sector increased to a 10-month high, while a sub-gauge measuring the outlook for the year ahead remained subdued, capped by concerns over the strength of the global economy. Hence, Beijing could stay on its current easing monetary trajectory, especially as uncertainties over the trade talks have re-emerged and the manufacturing sector remains in a frail state.

It's all about the Labor Market

The AUD/USD appreciated considerably by 0.8% on Tuesday after the RBA board decided to maintain its cash rate at a record low of 1.5% for the 30th monthly meeting in a row. The overnight swap market indicated a 45% probability for a lower cash rate and in a Bloomberg survey, 15 economists had expected a 25 basis point cut versus 14 who expected a no change outcome. As for the Bank's forecasts, the RBA lowered its price growth expectations to 1.75% for the current year (previously 2.0%) and 2.0% for 2020 (previously 2.25%). Monetary officials also lowered growth estimate for 2019 to 2.75% from February's assessment of 3.3%. Despite weaker expectations for inflation and growth, the Bank's argument for maintaining its monetary rate was based upon a robust labor market. It's still all about the labor market, that's what the RBA indicated. As long as the labor market is strong and continues to improve, the central bank will continue to believe that a tightening labor market will boost wages and inflation. Overall, it seems that interest rate trajectory will depend on the labor market and if the labor market were to weaken, then cash rate cuts maybe the outcome.

Kuwait

Kuwaiti Dinar at 0.30375

The USDKWD opened at 0.30375 Sunday morning.

Rates – 12 May, 2019

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	High	Low	Close	Minimum	Maximum	Forward
EUR	1.1194	1.1253	1.1164	1.1233	1.1110	1.1435	1.1323
GBP	1.3161	1.3163	1.2966	1.2998	1.2800	1.3205	1.3058
JPY	110.80	110.95	109.46	109.94	107.95	110.95	109.16
CHF	1.0160	1.0226	1.0098	1.0116	0.9925	1.0220	1.0032