

FED POLICYMAKERS SPLIT ON INFLATION VIEW

NBK MONEY MARKETS REPORT

Rates – 20th August, 2017

Currencies	Previous Week Levels				This Week's Expected Range		3-Month Forward
	Open	Low	High	Close	Minimum	Maximum	
EUR	1.1804	1.1661	1.1838	1.1760	1.1640	1.1950	1.1822
GBP	1.2992	1.2829	1.3022	1.2871	1.2710	1.2950	1.2920
JPY	109.05	108.58	110.94	109.17	107.30	110.15	108.69
CHF	0.9620	0.9584	0.9765	0.9648	0.9420	0.9840	0.9591

KUWAIT: Minutes from the Federal Reserve's July policy-setting meeting were released last week as investors awaited more details regarding the Central Bank's plan to move away from its crisis-era stimulus. In particular, economists were looking for hints as to when the Fed will begin taking steps to reduce its tremendous balance sheet size, as the quantitative easing programs have scooped up trillions of dollars of Treasuries and mortgage-backed securities during the financial crisis. Additionally, markets wanted to get a better feel for how many members remain resolved to raise interest rates again this year, and how many are wavering amid a five-month stretch of soft inflation reports.

Regarding the FOMC's views on the federal funds rate, the report stated that "some participants expressed concern about the recent decline in inflation, which had occurred even as resource utilization had tightened, and noted their increased uncertainty about the outlook for inflation. They observed that the Committee could afford to be patient under current circumstances in deciding when to increase the federal funds rate further and argued against additional adjustments until incoming information confirmed that the recent low readings on inflation were not likely to persist and that inflation was more clearly on a path toward the Committee's symmetric 2 percent objective over the medium term." Meanwhile, investors are still skeptical about a third rate hike before the end of the year, with the current probability standing at 31.2 percent in terms of market confidence, confirming that it will be a challenging time ahead for the Fed policy-setting committee.

With regards to the timeline of when the Fed intends to start the unwinding process, the minutes appeared to show that Federal Reserve policy makers were split over the decision. Some members "were prepared to announce a starting date for the [unwind] program at the current meeting", the report said. It also added "most [policymakers] preferred to defer that decision until an upcoming meeting while accumulating additional information on the economic outlook and developments potentially affecting financial markets".

Earlier during last week, US treasury yields enjoyed a mild boost on the back of solid retail sales. However, the yields managed to find their way back down after the release of the dovish FOMC minutes. Even so, political turmoil in the US and abroad garnered demand for safe, low-yielding bonds amongst nervous investors, dropping yields even further. The yield on the benchmark 10-year bond closed the week slightly lower at 2.1940 percent.

While the Dollar Index opened the week at 93.072, the greenback consistently strengthened throughout the week, and was supported further by strong retail sales data. However, the greenback faced downward pressure when the release of the Fed minutes coincided with US domestic troubles. Still, the dollar index managed to close the week higher at 93.434.

The euro was affected by a number of economic news and events last week. The single currency opened the week at 1.1804 and was mostly stable during the beginning of the week. However, the release of the FOMC minutes strengthened the euro as the dollar weakened across the board. Nonetheless, the euro hit its low of the month as the release of the ECB minutes indicated that policymakers were showing concern with regards to the euro's strength. Afterwards, the European currency

enjoyed a mild recovery as it closed the week at 1.1760. In the UK, the pound sterling weakened against the US dollar, mainly due to the weaker-than-expected inflation readings. The pair dipped by 0.64 percent as traders absorbed the news. Positive wage and unemployment indicators did not lift the Pound, as it closed the week lower at 1.2871.

In Japan, the yen failed to capitalize on strong GDP figures, which indicated that the economy grew at an annualized rate of 4.0 percent, the 6th straight quarter of expansion led by private consumption and capital expenditure. Even though the reading came in well above expectations of a 2.5 percent annualized increase, this information has failed to reflect positively on the Japanese yen which has traded weaker against the US dollar most of the week. Nevertheless, the yen managed to gain some ground against the greenback towards the end of the week, where the pair traded near 4 month lows after being triggered by the release of the FOMC minutes, which was viewed as slightly dovish by traders. The pair ended the week higher at 109.17.

On the commodities front, markets witnessed the largest drop in US crude stockpiles in almost a year. Crude oil inventories dropped by 8.9M barrels last week, and are currently at 4.9 percent below the level a year ago. The drop was more than double the decline forecasted by analysts at 3.1M barrels. However, despite the fall in inventories, which would normally give a strong lift to WTI crude prices, oil futures managed to fall immediately following the release of the EIA report. While oil prices opened the week at \$47.59, it closed it slightly higher at \$48.59.

US retail sales beat forecasts

United States retail sales figures came in well above market expectations. Whereas economists predicted a 0.4 percent m/m rise in sales, readings released by the Census Bureau showed that overall sales increased 0.6 percent from the previous month. Meanwhile, the core retail sales figure, which excludes automobile sales, came in at 0.5 percent m/m, also above expectations of 0.3 percent m/m. Even though the positive figures support the case of a third rate hike this year, markets are still skeptical, with the probability of a December hike currently sitting at 31.2 percent in terms of market confidence.

ECB policymakers

European Central Bank policymakers expressed concern regarding the euro's strength, according to the minutes of the ECB's July minutes. A strong euro is a hurdle

for the ECB needs to navigate around as it looks to unwind its quantitative easing program, which will at least continue until December of this year. Recently, the euro has climbed fiercely, reaching a two-and-a-half year high against the dollar and rising almost 5 percent against a basket of currencies since the middle of May. The strength of the single currency hinders the ECB's efforts of reaching its inflation goal of just under 2 percent, making imports cheaper and weighing on export growth. The minutes attributed the rise of the euro to the elimination of the political uncertainty following the election of Macron as well as market expectations over US interest rates. Following the report, the euro fell to its lowest level in three weeks. Nonetheless, it recouped its losses as it rose back to the same level later that day.

UK inflation disappoints

In the United Kingdom, the Consumer Price Index readings disappointed as they indicated inflation was weaker than expected. The official report indicated that consumer prices increased 2.6 percent in July, less than the 2.7 percent forecast by economists. The figures took their toll on the British pound, as it weakened against the Dollar. The Bank of England is facing a challenging time preparing the ground for higher borrowing costs against the backdrop of worsening economic indicators and continued uncertainty about Britain's exit from the European Union.

UK consumers squeezed

Wages in the UK rose 2.1 percent year-on-year and continued to lag behind a surge in consumer prices caused by the British pound's decline after the Brexit vote more than one year ago. Still, wage growth readings came in above expectations of 1.8 percent y/y, while the prior month's figure was revised up to 1.9 percent y/y. Per the Office for National Statistics, this leaves real incomes down by 0.5 percent y/y. Meanwhile, unemployment in the United Kingdom reached 4.4 percent, its lowest level in 42 years. Unemployment numbers beat forecasts of 4.5 percent, a match of the prior figure. In a further sign of labor-market tightness, the number of unemployed people per vacancy was at a record low of 1.9.

UK retail sales

Shoppers in the UK continued to spend at a rate higher than economists' expectations, as falls in all categories of expenditures were outweighed by higher spending on food, the official report on UK retail sales indicated. A 1.5 percent m/m increase in the volume spent in "predominantly food

stores" managed to prop up the final retail sales figure to a better-than-expected 0.3 percent m/m, versus expectations of 0.2 percent. Howard Archer, economist at EY Item Club commented on the contents of the report, saying that "a drop in most sales categories except food points to consumer caution in making discretionary purchases. This fuels suspicion that the pick-up in retail sales in the second quarter was partly a correction to the sharp fall in the first quarter, helped by some warmer weather and the later Easter."

Germany growth

In Germany, 2nd quarter growth numbers indicated the German economy grew by 0.6



percent, marking 3 straight years of growth. While the released number is not as bullish as analyst estimates, the 2nd quarter's growth is in line with the prior figure, which has been revised up to 0.7 percent. According to Destatis, Germany's federal statistics office, growth was supported by rising domestic demand and investment. However, trade may have held back growth after Germany suffered its worst month for exports in almost two years in June. Nevertheless, the recent solid economic data in Europe's largest economy has helped prop up Angela Merkel which is eyeing her 4th term as German Chancellor in the opinion polls ahead of the late September election.

RBA highlights household debt risk

The Royal Bank of Australia's minutes from its August meeting indicated that the central bank has removed the country's labor market from its watch list. The RBA left rates at record lows this month amid a feeling of confidence that inflation and jobs will pick up. However, the report also added that "members regarded conditions in the housing market and household balance sheets as continuing to warrant careful monitoring" and that the board needed to "balance the risks associated with high household debt in a low-inflation environment" by keeping policy unchanged. The Australian Dollar edged slightly higher immediately following the release of the report.

China growth stalls

Earlier last week, disappointing figures pointed to a second-half slowdown in China's economy. Industrial output readings in China were underwhelming, whereas analysts expected a 7.1 percent increase y/y, the figure came out at 6.4 percent. Prior to that, the figure was 7.6 percent in June. Additionally, retail sales increased 10.4 percent y/y, versus a forecast of 10.8 percent y/y. Furthermore, fixed-asset investment in urban areas rose 8.3 percent from a year earlier in the first seven months, versus a forecast 8.6 percent rise.

Japan exports on the rise

In Japan, exports rose for the eighth consecutive month in July after robust shipments to the United States. The recovery in overseas demand from a soft previous quarter underpins a recovering economy. The data underscores the Bank of Japan's view that the

CHINA'S SOLAR PANELS SHINE SPOTLIGHT ON N KOREA TRADE

DANDONG, China: Traders from North Korea visit Yuan Huan's shop in the Chinese border city of Dandong several times a month to place orders, bringing their own translators and wads of cash. Yuan, manager of Sangle Solar Power, said sales to North Koreans have soared in the past two years, one of the border businesses still thriving despite growing US pressure for China to limit commerce with the Stalinist regime.

Since North Korea mostly relies on outdated generators, blackouts are common and solar panels are prized for their role as backup power. Berkeley-based researchers at the Nautilus Institute estimated that at the end of 2014, about two percent of North Korea's population had acquired solar panels. And despite new United Nations sanctions further narrowing the categories of goods that can be traded with the hermit state this month, solar panels have remained off the growing blacklist. Yuan's shop offers a window into how Chinese traders do business with North Korea, a country with few allies and whose economy relies heavily on China's patronage.

Every day, trucks filled with cargo cross the Sino-Korean Friendship Bridge that connects Dandong to the North Korean city of Sinuiju. After receiving orders from North Korean customers, Yuan drops off packages at a riverside depot, and a Chinese logistics company takes care of transport across the waterway.

Some of her North Korean customers place orders by phone, but most prefer to make arrangements in person, she said. "It is actually quite easy for traders to go back and forth. Some buy over 20 units at a time," Yuan told AFP.

Several North Korean solar energy research and assembly plants have begun operation in recent



In this picture taken on July 6, 2017, solar panels are seen on the roof of a building in Dandong. — AFP

years, according to domestic media reports, but Chinese panels appear to remain in high demand. Last year, China exported 466,248 solar panels across the border, according to official figures from Beijing.

Immune from sanctions?

China on Tuesday started banning imports of iron, iron ore and seafood from North Korea as it implements the new UN sanctions, which could cost Pyongyang \$1 billion per year and were imposed after its two intercontinental ballistic missile tests. But in Dandong, where some 70 percent of trade between China and North Korea flows, solar panel merchants remain unfazed.

"It seems that overall, there are fewer North Korean traders coming over recently, but we're not affected by what's happening politically," said Shi Zhiyong, manager of the Huang Ming Solar Power shop. "In 2009, I started seeing more North Korean traders coming to the store and their numbers have only gone

up since," Shi told AFP. Both Yuan and Shi said their best-selling items are rooftop units that provide hot water supply. These cost between 2,700 and 14,000 yuan (\$400 and \$2,060). The purchases by households, offices and factories show that many urban residents have adequate disposable income, Johns Hopkins University researcher Curtis Melvin told AFP. "Aside from a few high-profile cases, such as the increase in fuel prices in North Korea or temporary suspension of coal exports to China, we haven't seen much evidence that (previous) sanctions have had a tremendously negative effect on North Korea's economy," Melvin added.

Sino-US relations have soured as President Donald Trump has pressed Beijing to step up pressure on North Korea, complaining about their continuing trade. In the first half, trade between China and North Korea increased 10.5 percent to \$2.5 billion, compared to the same period last year. — AFP

KOSOVO'S ELECTION DEADLOCK BLOCKS FUNDS, RECOGNITION

PRISTINA: Kosovo's failure to establish a government two months after an election is stalling its bids for greater international recognition and blocking funds for the poverty-stricken country. A coalition led by President Hashim Thaci's PDK party itself in power since 2007 — topped early parliamentary polls held on June 11, but the alliance did not win the absolute majority needed to govern alone. Made up of the old guard of ex-guerrilla fighters, the coalition can only form a government after nominating and winning support for a parliamentary speaker.

But so far the coalition has boycotted assembly sessions and a vote for speaker because it needs the backing of more deputies. "The ruling political class doesn't want to give up power," said Agron Bajrami, editor of the Koha Ditore newspaper.

Kosovo, a former Serbian province, unilaterally declared independence in 2008, backed by Western powers. The move has since been recognized by more than 110 countries-but not by Serbia or Russia-and Kosovo is not a United Nations member state.

The UN mission in Kosovo warned on Wednesday that the political deadlock was hurting the country economically and socially. "The election process itself consumed the energy of institutions during these past three months," UN envoy Zahir Tanin said at a Security Council meeting.

"Important economic and social opportunities were missed during such a period." The country is a potential candidate for European Union membership, but it now risks missing out on pre-accession assistance totalling 78 million euros (\$92 million) this year, according to the EU office in Pristina. The office said the funding program needs to be ratified by parliament and that this "should occur by December 2017, otherwise Kosovo will risk losing" the allocated aid. One

of the poorest parts of Europe, Kosovo also lost around 16 million euros in July from an International Monetary Fund program because there was no government to make a required legal amendment on war veterans, local media reported. Although the sum is relatively small, "this sends a bad message to all potential foreign investors on the situation in Kosovo," said economic analyst Naim Gashi.

Stalled accession bids

Hanging over Kosovo's political crisis is the creation of a new special court to try war crimes allegedly committed by members of the Kosovo Liberation Army (KLA), which fought Serbian forces for independence in the late 1990s. Thaci is speculated to be among those on the list of ex-KLA fighters to be indicted, which may be announced later this year.

Bajrami suggested that the PDK's keenness to cling to power was a self-preservation tactic, because "being in

power offers you more favorable conditions to negotiate immunity".

While the stalemate ensues, hopes are waning that Kosovo can join international organizations such as Interpol and UNESCO this year. Such accession bids have long been fiercely opposed by Serbia, but Kosovo's own internal woes are now holding them back. Kosovo's acting foreign minister Emanuel Demaj said the country had not yet reapplied for UNESCO membership, following a failed 2015 bid, with the UN cultural body's general conference taking place in two months. The new application depends on the amendment of two laws-one for religious freedoms another for cultural heritage-which are impossible to pass without a functioning parliament. Pristina has also applied for membership of Interpol, which meets in Beijing in late September, but Demaj said there were going to be "difficulties", with many member-states yet to respond to Kosovo's bid. —AFP



PRISTINA: This file photo taken on June 8, 2017 shows Kosovo Albanians walking past electoral banners in Pristina. Kosovo's failure to establish a government two months after an election is stalling its bids for greater international recognition and blocking funds for the poverty-stricken country. — AFP