Fed in tightening mode amid Asian meltdown

NBK MONEY MARKETS REPORT

KUWAIT: Interest rates hike expectations in the US have created a new world where consumers refuse to return to the debt-fueled demand growth of the previous years. After a massive expansion of its balance sheet, the Fed is now in a tightening mode, where Fed members are probably wondering if they acted too fast and what to do in the next FOMC meetings. As the world was waiting for the first rates hike in 2015, the problem today is in the interest rates path going forward.

Since the later part of 2015, we have seen carnage in emerging markets currencies and equities. Since the beginning of 2009, as funds were cheap, the Fed quantitative easing led to massive emerging market inflows, which led to years of foreign exchange intervention in an attempt for countries to keep their currency pegged or fight the increase relative to the Dollar. This phenomenon translated into a large investment in commodities which ultimately resulted in the burst we are currently witnessing.

The current situation is forcing consumers and investors to change their behavior as the old carry trade mechanism, where people used cheap funding currency to invest in higher yielding vehicles seems to be completely broken.

The drama is mainly hitting Asia, and mostly China. Even with Chinese authorities attempting to turn the country into a consumer driven society, it remains primarily an export oriented economy. With the Chinese export dropping significantly, authorities had no choice than to start devaluing the currency.

Having been pegged to the Dollar, the Yuan suffered major drawbacks relative to its competition. We are likely to witness a continuation of a drop in the Chinese Yuan into 2016, which ultimately will keep volatility elevated into emerging markets for the short term.

Since the start of 2016, China limit down was reached twice before authorities decided to scrap the newly adopted mechanism. Hibor rates which stand for interbank lending rates in Hong Kong have also exploded higher for two days this week in a sign that banks are desperate for liquidity and are extremely concerned about one another's counterparty risk. In all this meltdown, Chinese authorities waged war on speculators defending the Yuan offshore and Onshore continuously.

After continuous attempts of stabilization, Asian stock markets continue to bleed into the weekend with contagion spreading globally. Year to date, global indices are down almost double digits with Shanghai index down almost 20%, the Japanese Nikkei down 8%, while US and Europe indices down almost 8.5%.

On the currency front, the drop continues in commodities currencies, with year to date, Australian dollar down by 5.6 percent Canadian by 5 percent, South African by -6 percent and the list goes on.

Being the funding currency of choice, the Euro and the Yen are up against most of their counterparts. Euro closed the week at 1.0916 against the USD while the Japanese Yen closed the week at 117.00. The sterling Pound remains in a no man's land after investors remain on the sideline while the UK decides to remain or leave the Eurozone in 2016. On the commodities side, this week's comments from Nigeria's Oil Minister suggesting that a few OPEC member countries wanted to request an emergency meeting saw the price of oil attempting to move higher. Nonetheless, his comments were quickly downplayed by his counterpart in the UAE who said that the OPEC will not change its policy despite the latest price collapse. Oil is now down 50 percent from its peak in June last year, or over 72 percent from the highs of June 2014. Brent ended the week down over 20 percent since the beginning of the year at $29.42, while West Texas crude closed below the $30 level the first time since 2003 at $28.94.

Worried Fed

President of St Louis Fed, James Bullard who is seen to be a hawkish member of the FOMC committee, commented this week, saying that 'with renewed declines in crude oil prices in recent weeks, the associated decline in market based inflation expectations measures is becoming worrisome'. Bullard noted that while Central Bankers tend to 'look through' the changes in the price of oil, 'one circumstance where one may be concerned is when inflation expectations themselves begin to change due to the changes in crude oil prices'.

After ruling out a January rate move, he said that no decision on March can be made until we "get more information and see how things play out". The probability of a March hike has fallen from as much 52 percent at the start of the year to just 33 percent now.

Another Fed member, president of San Francisco Fed John Williams admitted this week that "the Fed got it wrong when it predicted a drop in oil prices would be a big boom for the

economy. It turned out the world had changed; the US has a lot of jobs connected to the oil industry". Now that gas prices have been low for over a year, consumers will finally change their behavior having expected the gas drop to be temporary. Consumer spending that has been growing faster last year will eventually stop, making the Fed realize that the world wasn't ready for a major lift off as planned

Boston Fed President Rosengren also attracted some attention this week making reference to the fact that "policy makers should take seriously the potential downside risks to their economic forecasts and manage those risks as we think about the appropriate path for monetary policy".

Rosengren continue saying that these "downside risks reflect continued headwinds from weakness within countries that represent many of our major trading partners, and only limited data to support the projected path of inflation".

Last but not least, Chicago Fed President Evans reiterated his view that "we are likely headed toward a lower resting point" for the fed funds rate relative to the past, while also citing that the policy of normalization should be "very gradual" to bring inflation to target in a reasonable amount of time.

Europe & UK

German 2015 GDP growth came in at +1.7 percent on a yearly basis, which was as expected and slightly better than 2014, 1.6 percent. The outcome is in line with the expectations of the German government and the Bundesbank. Preliminary GDP data for Q4 signaled a slight loss in momentum in the second half of the year. Germany's GDP expanded around 0.25 percent in the final quarter of 2015 from the previous period. Europe continues to steal growth from its major partner with the help of a falling Euro. A week ago, the eurozone PMI came at 54.2, unchanged from November, but up from the prior 53.9. Firms in Europe as well continue to add new jobs at the fastest rate since May 2011 anticipating better business this year. The employment sub-index was 52.8 in December from 52.2

The ECB meeting minutes

The minutes of the latest ECB meeting released this week highlighted that policy action was widely seen as warranted and a 'reassessment could made in the future' about increasing the size of monthly purchases. Highlighting a split amongst the board, the minutes notes in the text were that 'going beyond the ultimately agreed 10bp cut would, in the view of some members, raise issues about increase side effects over time'.

The minutes also reiterated that these issues concerned the profitability of banks and other financial institutions whereby banks could try to recoup possible losses by increasing lending margins and so leading to a tightening instead of a further easing in financing conditions.

Dim forecasts for UK

The Bank of England kept rates unchanged once again this week after an 8-1 majority vote. Officials said the near-term outlook for UK growth and inflation has weakened further.

In the minutes of the January meeting, published this week, officials said they needed time to assess the implications of recent market volatility. With inflation far below the BOE's 2 percent target, officials also noted that pay growth remains "restrained" and has dipped in recent months. The expected pickup in the headline rate would be "a little more modest than previously assumed," while business surveys point to a slower pace of growth. The minutes also highlighted that the falls in energy prices meant that the increase in inflation is now expected to be slightly more gradual in the near term than forecast in the committee's November Inflation report, although the comments were somewhat balanced out with the reference to potentially being positive for consumer spending.

Bank of Japan

This week, Japan machine orders dropped this week by 14.4 percent on a monthly basis, worth 773.8 billion yen. The headline figure missed forecasts for a drop of 7.3 percent, following the 10.7 percent increase in October. Bank of Japan said that producer prices were also down 0.3 percent on a monthly basis in December.

For now, the continuation of the global meltdown has supported the Yen, as well as Japan's balance of payments. On the trade side, although the trade deficit has shrunk to close to zero, falling energy import prices have offset the export drag from the lower in Asia.

Australia's Job data

On the data front this week, employment declined by 1,000 since November against expectations of 10,000 drop while unemployment was at 5.8 percent versus expectations of 5.9 percent. We believe that Australia continues to be mostly vulnerable to the Chinese currency weakness. If the depreciation of the Yuan remains aggressive in 2016, it is likely to generate additional stress for the Australian economy. Indeed, the longer the crisis prolongs in Asia, the more difficult it would be for new mining investment to take place.

The latest trade numbers were released with the data better than expected this week. In yuan terms, exports were up +2.3 percent on a yearly basis in December against. -4.1 percent from - 3.7 percent in November. It was the first positive reading since June last year. Imports printed at -4.0 percent on a yearly basis, against expectations of -7.9 percent, from -5.6 percent the prior month.

When translated in USD terms, exports rose to -1.4 percent against expectations of a 8.0 percent drop from -6.8 percent the previous month, while imports came at -7.6 percent against expectations of -11.0 percent. With the devaluation of the Yuan, that data is likely to provide a lift to the PBoC. Taken together, the data suggest a favorable impact from currency depreciation.

With the December trade data, China's is attempting to reassure markets despite the turmoil on the stock and FX markets. Despite taking long time to materialize, Chinese authorities are betting the strategy is moving in the right path.

Kuwait

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The USDKWD opened at 0.30355 yesterday morning.

Vietnam sees reform opportunities, labor challenges in TPP

HANOI: After organizing communist Vietnam's first peaceful mass strike at a shoe factory, labor activist Do Thi Minh Hanh was arrested, beaten bloody by police, and jailed for four years. Authoritarian Vietnam does not allow the millions of workers in its export-orientated factories, which are driving impressive economic growth, to form independent trade unions.

But this should change with the coming into force of the Trans-Pacific Partnership (TPP), a deal that has been touted as a foundation for "21st century trade" by US President Barack Obama. The TPP seeks to liberalise commerce in some 40 percent of the global economy, and if ratified would oblige signatories-be they the US, Japan, Canada or Vietnam-to allow independent trade unions.

But activists like Hanh say the one-party state is a long way from concretely committing to that kind of change. "Vietnam still wants to maintain its monopoly on trade unions," said Hanh, who was released from prison in 2014 but lives under constant police surveillance. Currently, all unions are part of the Vietnam Confederation of Labour, which is older than the ruling communist party.

Such official unions are "established to control workers, not to represent them," activist Hoang Dung said. The lack of meaningful representation is counterproductive as it leads to more wildcat strikes, said labor activist Nguyen Ngoc Nhu Quynh.

"Workers demonstrate as they cannot negotiate," she said. Quynh is not optimistic about the TPP as "who can ensure that the trade union is really independent and will listen to workers' concerns?"

Company vs worker rights

The TPP contains a controversial investor-state dispute settlement mechanism which allows companies to take governments to court if they feel their rights are violated. But the deal has no equivalent enforcement mechanism to make sure member states live up to their commitments on labor or the environment.

Oxfam's Andrew Wells-Dang notes that Vietnam has signed up for numerous rights and labor agreements in the past but failed to implement them. The TPP "could contribute to opening up space on labor issues... but what happens if it doesn't?" he said.

The risk is the deal will simply "replace one set of (local) state owned actors with another set of international corporate actors," and do little to benefit workers or farmers.

Vietnam, whose low-wage economy relies heavily on exports, is projected to see the biggest percentage boost to the economy of any country in the TPP-about 10 percent by 2030, mostly thanks to textiles and apparel, according to World Bank figures. Last year the economy grew at 6.68 percent, its fastest pace in five years, partially thanks to record foreign investment.

But in order to attract new high-quality TPP-linked investment, the communist country, which has the lowest GDP per capita and competitiveness ranking of the group, will have to introduce wide-ranging reforms.

"It requires a lot of effort for Vietnam to develop a full market system and define better the role of the state," said economist Pham Chi Lan. From brewing to baby formula, often inefficient state-run companies still have their fingers in every sector of the economy, and restructuring will be a long and painful process, she said.

But when the country signed on to the TPP it showed "they are serious about changing the system," she said.

Geopolitical victory

Vietnam's participation in the TPP reflects a "new consensus" among the country's ruling elite about their foreign policy direction, said Jonathan London, a Vietnam expert at City University of Hong Kong.

The communist country wants to move close to the US and Japan, but is also eager not to antagonize its current largest trading partner Beijing, he said. "Hanoi recognizes the TPP for what it is: a once in a generation opportunity to bolster the country's standings, economically and strategically," he said. The TPP will help Vietnam's domestic reform by putting "structure and direction" into long-running efforts to overhaul the state sector, but while the pact offers tremendous opportunities to Vietnam, it is no magic bullet, said Virginia Foote of Bay Global Strategies.

"Companies look at the overall picture, if the only thing that is better is tariff levels, you might not move your factory or supply chain (there)," she said. At the Garment Textile Corporation factory on the outskirts of Hanoi, the company has been planning eagerly for a post TPP era, said deputy director Than Duc Viet. It has nearly doubled production capacity and is busy securing local supplies to take advantage of a provision which rewards member states for using yarn from other TPP countries.

The deals new labor standards are no concern, he added, as his company already invests heavily in perks to help retain skilled workers. "With or without TPP, we will certainly be bankrupt if workers don't want to stay," he said. —AFP

KANO: A trader sorts a basket of tomatoes at the Yankaba vegetables market in northern Nigerian city of Kano, yesterday. —AFP

Nigeria tackling poverty and unemployment with tomatoes

Africa's richest man Dangote hoping to boost output, create jobs

KANO, Nigeria: It's a situation that mirrors the giant oil industry, where Nigeria has abundant resources but has lacked the capacity, will or ability to exploit it, forcing a reliance on imports.

But Africa's richest man Aliko Dangote is hoping to change tomato production with a giant factory that will boost domestic output, create jobs-and even, indirectly, fight Boko Haram.

For the past five years, the Dangote Group conglomerate he heads has been working to build a $20-million (18.4-million-euro) tomato processing plant outside the northern city of Kano. The city and state of the same name has been blighted by poverty and unemployment, seen as key drivers to radicalisation fuelling the Islamist insurgency in the wider north since 2009. But it's hoped the giant factory the size of 10 football pitches, set alongside 17,000 hectares (acres) of irrigated fields, will help by tapping a potential agricultural goldmine.

The country's agriculture ministry puts annual current demand for tomato puree at 900,000 tons. When the Dangote factory opens from next month it will provide 430,000 tons of paste that is used widely in Nigerian dishes from jollof rice to fiery soups. "Nigeria is such a huge market for tomato paste that we will find quite challenging to satisfy," the factory's general manager, Abdulkarim Kaita, said.

"Already local tomato paste packaging companies have placed orders with us which we will have to work hard to satisfy. "We are set to begin operations. We are only waiting for the tomatoes which are ripening in the fields."

Supply boost

Nigeria grows some 1.5 million tons of tomatoes every year, making it the 14th biggest producer in the world. But it's forced to rely on imports of tomato puree, mostly from China, because of a lack of processing plants. Dangote's factory, built by Switzerland-based Syngenta, will directly employ 120 people and 50,000 farmers have been engaged to grow the tomatoes required for the process of making concentrate. The Central Bank of Nigeria has provided technical assistance such as soft loans for seeds and fertilizer. The factory will then buy the produce at competitive rates, said Kaita.

Currently, about half of the local tomato crop rots because of a lack of storage facilities, poor pricing and access to markets, which has prompted many farmers to stop cultivation, said the CBN.

The improved seed varieties to increase yields, access to chemicals, more up-to-date farming techniques and a ready market for the produce is designed to entice farmers back.

"Once we start production the factory will be providing employment to farmers and (the) tomato paste packaging industry, traders, haulage operators and many others to support the tomato value chain," said production manager Ashwin Patil. Plans to increase production-and acquire an idle tomato paste factory in neighboring Kaduna state-are in the pipeline, he added.

For farmers such as Yusuf Ado Kadawa, it's a lifeline. "We really incur heavy losses from our yield, which rots away due to lack of (a) ready market for our tomatoes, which is a perishable produce. But now we have a market close to us," he said.

Challenges

President Muhammadu Buhari is keen to diversify Nigeria's economy away from an over-reliance on oil as revenues have been severely depleted by the global slump in crude prices. Former agriculture minister Akinwumi Adesina, now head of the African Development Bank, in 2013 described the sector as "the new oil". Some 30 percent of Nigeria's estimated 170 million people are employed in agriculture, mostly at a subsistence level, although moves have been made to commercialize production. Erratic power supply, which Nigeria has been grappling with for more than two decades, and lack of import controls remain the factory's main challenges.

The factory will have to rely on diesel-hungry generators for electricity, adding to production costs and reducing competitiveness with cheaper imports.

Both issues contributed to the collapse of hundreds of factories in Dangote's home state of Kano in the past two decades, including his textile and wheat flour factories.But the vice-president of Nigeria's manufacturers union, Ali Madugu, said the future still looked bright.

"Once the government can place restrictions on the import of Chinese tomato pastes... the sky's the limit for the Dangote tomato paste because the market is there for them to exploit," he added. —AFP