World markets diverge ahead of Fed speech

LONDON: World equity markets trod water yesterday as investors awaited signals from Federal Reserve chief Janet Yellen about the possible timing of the next interest rate hike. "Global equities are lacklustre into the weekend as profit taking grips investors on both sides of the pond following recent record highs," said Accendo analyst Henry Croft. "Investors are also looking ahead to a choir of Fed speakers - including chair Yellen - this afternoon ahead of the central bank's self-imposed blackout period before the March 15 meeting," he said.

Oanda analyst Craig Erlam said the week "has already been dominated by the US central bank, with a large number of Fed officials making public appearances ahead of the blackout period-which starts tomorrow - and voicing their support for a rate hike very soon." The odds were now more than 75 percent that a rate hike was forthcoming, the expert said, with some seeing an even higher probability.

Yellen and four more officials, including vice chairman Stanley Fischer, were scheduled to speak later yesterday and "it is now down to them to fine tune the message and ensure markets are properly positioned ahead" of the next rate-setting meeting, he said. Even Fed governor Lael Brainard, a so-called "dove" on monetary policy, suggested rates could rise soon.

'Fait accompli'

The "hawks" at the Federal Reserve are more concerned about the threat of rising inflation, especially if tax cuts and spending fuel the economy, but the "doves" warn of the risk of raising interest rates based on policies that have not been announced, and whose implications cannot yet be measured. Brainard "has tipped the scales in overwhelming favour of a rate hike as the market now views March as fait accompli," one trader said.

The dollar had rallied strongly since the start of February, but "whether the dollar is able to build on these gains in today's session will depend on just how hawkish policy makers are," said Oanda's Erlam. The greenback broke above 114 yen for the first time in two weeks on Thursday and remained above the level heading into the weekend break.

Elsewhere, oil prices climbed after tumbling more than two percent Thursday in reaction to the stronger dollar - which makes the commodity more expensive for holders of other currencies - and news that Russia was well short of its promised output cuts.

Despite agreeing to slash production as part of a deal with global producers to address a global glut, Moscow's reductions were only a third of what it pledged in January and February. — AFP

CHENNAI: An Indian boy looks at artificial floral bouquets at a market yesterday. — AFP

US Fed and ECB going their separate ways

GLOBAL ECONOMY WEEK AHEAD

FRANKFURT: Two of the world's biggest central banks are likely to find themselves with a bigger policy gap by the end of the coming fortnight the European Central Bank on Thursday will resist calls to start tightening policy against surging inflation but robust US jobs data on Friday could seal the case for another Federal Reserve hike the week after. So, let's say minus 0.4 percent rates in Europe and more than 0.75 percent in Washington.

With just weeks to go before contentious French and Dutch elections, the ECB will be keen not to rock the boat, so it is likely to give just a token nod to robust growth figures, steering clear of any policy hint that may give emerging populist movements ammunition. A Reuters poll showed unanimity for no change. But the balancing act may be more difficult than it looks. With growth on its best run since before the financial crisis and inflation peeking just above the ECB's target, calls are mounting, particularly in Germany, for the bank to scale back its 2.3 trillion euro ($2.42 trillion) bond buying scheme and raise its negative interest rates.

Doves hold a comfortable majority among the policymakers, however, so any shift will come at the margins. In practice that could mean increased inflation forecasts, letting an ultra-cheap lending scheme to banks expire as scheduled, and dropping a reference to the risk that growth may disappoint. Still, ECB President Mario Draghi will probably avoid any discussion about winding down asset buys, even pushing back on calls by some rate setters to tweak the ECB's guidance, giving up its reference to further rate cuts, a possibility markets have already priced out.

"If the French presidential election also passes without turbulence, and growth and inflation data remain solid, the ECB might turn more hawkish in its meeting on June 8," Reinhard Cluse, economist at investment bank UBS, said. "This would then leave the meeting on July 20 for preparing the markets for the tapering (off asset-buying) on September 7." For now though, Draghi will stick to his line that the inflation surge is temporary, growth is fragile and political risks clouds the outlook, requiring stimulus, a Reuters poll of analysts showed.

Having tightened policy in 2011 just months before the euro zone debt crisis started spiralling out of control, the ECB will be desperate not to move too early, even if it risks being called out by some for moving too late.

US jobs

The Fed, meanwhile, must deal with what Draghi dubbed a high-class problem: solid growth, full employment and returning inflation. Non-farm payrolls yesterday showed an increase of 186,000 jobs, probably enough to push the Fed to move. Unemployment benefits already fell to near a 44-year low late last month, indicating further tightening of the labor market.

Indeed, markets have now almost fully priced in a hike in March, the third since rates bottomed out at the height of the crisis, and two more increases could still come before the end of the year. Robust jobs growth threatens to overheat the labour market, just as inflation is heading higher, with the Fed's preferred measure now in the upper end of the range central bank officials in December estimated would be reached this year.

Manufacturing growth is also firming, offsetting relatively weak consumer demand, good enough for even the most dovish Fed officials to argue for a hike sooner rather than later. Soothing global growth fears, meanwhile, China is expected to report another set of strong figures for both exports and imports, indicating that even if overall growth is slowing and debt is rising fast, the slowdown remains under control, mitigating the risk for emerging market economies.

Indeed, China's factory activity expanded faster than expected in February, firming arguments for the central bank to raise short-term interest rates by a another 10 basis points as soon as March. Data due on Wednesday are expected to show Chinese exports up by 10 percent in February while imports could have risen by 20 percent, a boon for countries like Australia, which supply China with raw materials. Indeed, the Reserve Bank of Australia may signal on Tuesday that policy easing is done, given the economy's convincing rebound last quarter, rising commodity exports and a robust increase in household debt levels. — Reuters

Dollar retreats

NEW YORK: The dollar weakened against a basket of major currencies yesterday ahead of a speech by Federal Reserve chief Janet Yellen that could affirm expectations for an interest rate hike on March 15. The dollar is up about 0.74 percent this week, its fourth straight weekly gain, boosted by hawkish comments from a slew of Fed speakers that have led to a dramatic revising of rate hike expectations. Speeches from Yellen and Fed Vice Chair Stanley Fischer are now widely expected to be the final clues to the timing of the next rate hike.

Futures traders now are pricing in an 80 percent chance of a Fed hike in March, up from 35 percent on Tuesday, according to the CME Group's FedWatch Tool. "The markets are looking for validation for the increase in Fed rate hike expectations from comments from Fed Chair Yellen. That's the key issue for the market right now," said Shaun Osborne, chief FX strategist, at Scotiabank in Toronto.

The dollar was down 0.32 percent at 101.87 against a basket of six major currencies. On Thursday, the index hit a seven-week high of 102.26. Against the Japanese yen the greenback was little changed. The euro rose 0.48 percent against the dollar after a poll showed French far-right candidate Marine Le Pen's chances in the country's presidential election dimming.

While the French election news may be supportive for the euro at the margin, the political race has not necessarily been the main driver for the euro's recent weakness, Scotiabank's Osborne said. "That's more about the shift in relative yields and monetary stance given the move in short-term rates in the US," he said. US two-year Treasury yields hit their highest in more than 7-1/2 years on Thursday.

Rate hike expectations also weighed on the Australian and New Zealand dollars, both of which fell against the greenback. The kiwi dollar was down 0.69 percent, while the Aussie was down 0.09 percent. "People were not expecting the Fed to move in March so last month they were putting on more (interest rate) carry trades in these currencies," said Bank of Montreal head of European FX strategist Stephen Gallo. "That is clearly coming off." Mexico's peso strengthened to its strongest level since the U.S. presidential election in November, after US Secretary of Commerce Wilbur Ross said a sensible trade deal with Mexico will help the battered currency. — Reuters