NBK Money Market Report

Dollar tumbles as demand for safe havens intensifies

Markets still grappling with dollar weakness

KUWAIT: Markets are struggling to comprehend the recent feebleness of the dollar in a period of rising Treasury yields and a massive fiscal stimulus injected in the American economy. Inflation expectations have risen across the board and the Fed's tone indicates no hesitation in tightening its monetary stance. So what could the factors driving the US dollar into continuous negative territory be? The logical answers would be the US budget deficit, trade protectionism, politics in Washington, and hawkish central banks around the globe.

Looking at the national debt, which hovers around $20.6 trillion and accounts to 105 percent of GDP, it is estimated to grow to 150 percent of GDP by 2047 according to a study done by the Congressional Budget Office. The latest tax cuts and the budget plan that elevated spending limits by $300 billion over the next two years. Coupled with rising interest rates, this poses a great risk to the US, especially if the economy takes a downturn in the future as we have witnessed in the years 2000 and 2008.

As for Trump's approval rating, there has been a rise from 38 percent calculated two months ago to nearly 43.5 percent last week. The rise is mainly attributed to the passage of the tax cut. These numbers will convey to the President that if you follow through on election campaign promises it benefits your approval rating. Trade protectionism was one of the main themes during Trump's campaigning, so it is likely that this will now be the focus of policy direction in the coming months as the mid-term election takes place this year.

BoE policy makers have tuned their interest rate expectations upward. The ECB is anticipated to end its bond buying program this year and hike interest rates in early 2019. However, the BoJ seems dovish about changing its monetary stance especially with the reappointment of Governor Kurodo. Interestingly, the Japanese yen and Swiss franc have been the top two performers among G10 currencies on YTD basis. The reason is that demand for safe haven assets are on the rise due to market volatility. Higher Treasury yields caused a sell-off in the equity and bond markets. It seems investors are waiting for yields to climb further before they reinvest in the above markets.

On the currency front, last week the US dollar index declined substantially to the lowest level since December 2014. Rising US Treasury yields were overshadowed by negative sentiment. The DXY began its weekly session at 90.129 and closed at 89.100. The index lost 1.14 percent of its value last week.

It was a light week in terms of economic data for the single currency and the euro didn't hesitate to take advantage of the Dollar's weakness. The EUR/USD appreciated to 1.2555, the highest level witnessed since December 2014. The euro gained 1.24 percent versus the dollar last week.

In regards to the pound sterling, the GBP/USD found support at the start of the week after BoE policy makers sounded hawkish on interest rates. The sterling rose to 1.4144 versus the greenback on Friday, an 11-day high. Some of the gains were lost after UK retail sales came below expectations. The GBP/USD ended last week's session at 1.4040.

Safe haven assets (JPY, CHF and gold) have been in demand lately as investors sought shelter after the recent spike in markets volatility and uncertainty about US politics. The yen soared to a 15 month high, while the CHF appreciated to the highest level since June 2015 versus the Dollar. The yellow metal was elevated near one month high and closed at $1,347.77 on Friday.

Inflation points to higher rates

Inflation in America surprised markets to the upside last month as the headline and core figures surpassed estimates. Headline CPI rose 0.5 percent while the core index rose 0.3 percent. On a yearly basis headline CPI was steady at 2.1 percent as the core rate persisted at 1.8 percent. Energy prices surged 3.0 percent in January, with a 5.7 percent increase in gasoline prices while clothing prices rose by 1.7 percent. Even after the strong rise in wages seen in January, the increase in CPI has come a lot earlier than many had anticipated even before fiscal stimulus measures and increased government spending have had any meaningful impact on the economy. This sets the stage for an interest rate hike by the Federal Reserve in March. The Fed Funds market indicates that investors now widely expect the US central bank to raise interest rates at least three times this year. The latest data supports the theme that a new era of reflation has emerged after years of subdued price growth.

Rate hike hopes high for Japan and eurozone

On the producer front, price growth also found support from the energy sector. The headline and core PPI both rose 0.4 percent from the previous month. Compared to a year ago, producer prices were up by 2.7 percent in January, reflecting a slight increase from the 2.6 percent in December, while core data declined slightly last month to 2.2 percent from 2.3 percent. Whole sale inflation may find further upward assistance moving forward due to Dollar weakness and President Trump's trade agenda.

Retail sales disappoint

Consumers in the US cut back purchases on motor vehicles, furniture and other products in January, which pressured retail sales into negative territory of -0.3 percent m/m. The recent softness in the last two readings was larger than expected and could trim overall growth forecasts for the current quarter. Looking backwards, spending in 2017 was robust, enhanced by a drop in the average savings rate. The fresh dip in retail spending could be the start of a cutback on the part of consumers as they attempt to bring the average rate of saving back up. Overall consumer spending has decent support looking forward, especially since tax cuts will lift disposable income. However, after the speedy rise in expenditure during the second half of 2017, the first half of 2018 may witness a more moderate pace of spending.

Rates – 18 February, 2018

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.2252	1.2233	1.2555	1.2404	1.2205	1.2605	1.2487
GBP	1.3826	1.3794	1.4144	1.4040	1.3835	1.4240	1.4084
JPY	108.84	105.52	108.84	106.30	104.35	107.30	105.71
CHF	0.9401	0.9186	0.9402	0.9276	0.9075	0.9485	0.9212

EU GDP at 10 years high

The 28 members of the EU experienced the strongest expansion in a decade last year. The single economy grew 2.5 percent annually and 0.6 percent in Q4 2017. As for Europe's core economy, Germany recorded a full-year growth of 2.2 percent, the highest since 2011 according to the country's Federal Statistics Office. Growth was motivated by solid investment and exports, although private consumption eased a little from previous quarters. Looking at internal factors, domestic demand was horizontal in Germany during the last quarter. Even with the low unemployment rate, tight labor market and signs of upward wages momentum, hopes were high for German consumers to finally start to do the heavy lifting in terms euro-area growth. In regards to monetary policy, QE seems to be coming to an end this year and the recent appreciation of the euro poses a bit of a headache for the ECB.

High inflation

The persistence of high CPI in Britain supports the case that inflation is unlikely to fall back quickly and may take several years before the BoE feels comfortable with the inflation levels. The latest readings on consumer and wage inflation reinforce the case for borrowing rates to head north in order to tame the overshooting price growth. Markets expect a 70 percent probability of a quarter-point rise in interest rates by May, and a roughly 50 percent chance of a further increase in rates to 1 percent by year end.

Last week's print presented little news to the MPC, who predicted January inflation of 3 percent on an annual basis. The BoE's strategy depends on the expectation that continuous strength in the labor market could create excess demand in the economy, which in turn should push up domestically-generated inflation. For that reason, the MPC appeared to broadly endorse market expectations for around three further rate increases over the next three years.

In details, consumer price growth remained constant at 3 percent versus an expectation of a dip to 2.9 percent by markets, while the core data increased by 0.2 percent to 2.7 percent. The core CPI was enhanced as the price for services rose to 2.8 percent, compared with the previous reading of 2.5 percent. With wages gaining momentum, we could expect higher core figures because the cost of services are thought to be more sensitive to changes in the cost of labor, while the prices of goods are more dependent on the exchange rate. Lately, policy makers at the BoE have adjusted their dovish tone thanks to a worldwide economic recovery and indications of a pick-up in Britain's wage growth. British citizens behavior was another factor for the hawkish outlook on interest rates as their willingness to borrow demonstrated that the economy is ready for somewhat higher borrowing costs. Former dovish member Vlieghe stated that the willingness of UK residents to borrow implies that at current interest rates they no longer want to ease debt burdens. Numerous members of the MPC have said they expect rates to rise again after the Bank maintained its monetary stance at their last meeting. The question has now moved from when it will hike to the pace of further tightening. Even with all the recent optimism emerging lately, uncertainty looms over the UK about the correct equilibrium level for interest rates, and that would depend on the economic impact of Britain's departure from the EU in March 2019.

Japan's GDP

The Japanese economy continued its expansion in the last quarter of 2017, but the rate of growth has slowed down significantly. The preliminary GDP reading came in at 0.5 percent annually, lower than the forecasted 0.9 percent. Quarter on quarter GDP rose 0.1 percent, slowing from the 0.3 percent increase in the third quarter. Nevertheless, the economy still performed strongly last year as whole when it expanded by 1.6 percent which was the fastest calendar year of growth since 2010. The perseverance in Japan's growth is due to strong global demand that assisted Japanese manufacturers, and kept the jobless rate below 3 percent. However, on the wages side no upward momentum was witnessed. The leisureliest economic growth in nearly two years (0.1 percent) and an appreciated yen that stands at 15 months high, highlights the ongoing struggle to revive inflation even as prices elsewhere in the developed world begin to inch higher. The decline in momentum suggests that the economy is still some way from being self-sustaining, and will likely mean that monetary policy will remain on hold for a considerable period longer.

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Kuwaiti dinar at 0.29940

The USDKWD opened at 0.29940 yesterday morning.

$1.8bn PNB fraud ripples through India's banks

NEW DELHI: An Indian supporter of the Congress Party keeps his hand on the face of a cut out of billionaire jeweler Nirav Modi during a protest in New Delhi on Friday.—AFP

NEW DELHI/MUMBAI: Close on the heels of the arrest of two employees of Punjab National Bank, the state-run lender that has been the victim of a $1.77 billion fraud, India's Income Tax department warned in an internal note seen by Reuters that domestic banks could take a hit of more than $3 billion from loans and corporate guarantees provided to Modi and Choksi.

The two employees —Gokulnath Shetty and Manoj Kharat- are suspected of steering fraudulent loans to companies linked to billionaire jeweler Nirav Modi and entities tied to jewelry retailer Gitanjali, which is led by Modi's uncle, Mehul Choksi.

The arrests, late on Friday, came two days after India's second-largest state-run lender said it had been hit by massive fraud, sending its share price tumbling. The accusations against the two relatively junior PNB officials were detailed in the lender's disclosure, and also contained in a preliminary police report.

The Central Bureau of Investigation (CBI) also arrested a third person, Hemant Bhat, whom a source described as the "authorized signatory" of the companies tied to Nirav Modi.

All three appeared before a hot, packed courtroom in Mumbai on Saturday afternoon, where they were ordered to remain under police custody until March 3 to allow the CBI to continue its investigation. No charges have yet been laid. "CBI must get fair chance to investigate this very serious offence, which has consequences for the country's economy," said judge S R Tamboli, as PNB employee Shetty shifted nervously and blinked frequently. The other two stood passively.

Family members of the accused present at the court defended them, saying they were innocent.

Kharat's uncle told Reuters the PNB employee was "just following orders of superiors" and added "he wasn't aware of what he is doing".

Probe widens

A police source said six more PNB employees were "being examined" after the CBI conducted additional searches at the PNB's branch in southern Mumbai where the alleged fraud took place.

Police sources say Modi, whose high-end jewelry has been worn by Hollywood stars including Kate Winslet, and Choksi left India last month and their whereabouts are unknown. Neither Modi nor Choksi have so far commented on the allegations. Gitanjali has previously denied Choksi's involvement in the fraud and said he would take "necessary legal action" to get his name removed from the police case. TV station NDTV on Friday reported Modi was at a suite in a New York hotel, citing household staff who answered the door.

On Saturday, a police source said that the CBI had sent a notice through Interpol in a bid to help locate Modi. Meanwhile the Enforcement Directorate, India's financial crime agency, said on Saturday it conducted additional searches at 21 locations of companies tied to Modi, seizing 250 million rupees ($3.89 million) in precious stones, metals and jewellery.

Both authorities have conducted dozens of raids since PNB disclosed the fraud, targeting PNB, Modi and Choksi, with the Enforcement Directorate now having seized diamonds, gold and jewellery worth 56.7 billion rupees.

A tax department spokeswoman told Reuters officials had seized 29 properties and 105 bank accounts linked to Modi.

Financial impact

The biggest bank fraud in India's history has sent rumbles through India's financial system, raising fears about the scale of problems in the banking sector that is already saddled with $147 billion of soured debt.

PNB said on Friday it was running an audit of its systems to prevent a recurrence of such a fraud, but did not see a long-term hit to its operations. The bank, which has $120 billion in total assets, has lost more than a fifth of its market value since it disclosed the fraud.

The Hindu newspaper reported on Saturday that the Central Vigilance Commission, which investigates corruption in the government, has summoned senior officials of the Reserve Bank of India and the Finance Ministry to assess how all internal checks and balances failed to detect the fraud.

PNB officials were also summoned, the report said, citing an official aware of the development.

The RBI did not reply to an emailed request for comment. A Finance Ministry spokesman was not immediately reachable. Scrutiny of banks' technical systems will intensify even further after India's City Union Bank Ltd on Saturday said it had suffered three "fraudulent remittances" of nearly $2 million that had been pushed through the SWIFT financial platform. The case was reminiscent of the $81 million cyber heist that hit Bangladesh's central bank in 2016. —Reuters

Russian lawmaker Kerimov strikes deal to buy Vozrozhdenie bank

MOSCOW: Russian businessman and lawmaker Suleiman Kerimov has reached an agreement to buy Vozrozhdenie bank from its majority owners, brothers Dmitry and Alexei Ananyev, three sources close to the deal told Reuters. The sale forms part of the fallout from a sweeping clean-up of the Russian banking sector last year, which saw the central bank rescue three major lenders, including Promsvyazbank, also owned by the Ananyev brothers.

Under the terms of that bailout, the central bank gave the brothers 90 days to reduce their stake in Vozrozhdenie down to 10 percent, from the approximately 80 percent they currently hold. Earlier this month two sources told Reuters that Kerimov, whose family controls Russia's top gold producer Polyus , had entered the race to buy Vozrozhdenie.

Kerimov is ranked by Forbes magazine as Russia's 21st wealthiest businessman, with a net worth of $6.3 billion. He is currently under investigation in France for tax evasion, but was granted permission by French authorities to travel to Russia in January. The three-day business trip was aimed at finalizing the Vozrozhdenie deal, one source said. He is now back in France and denies the prosecutors' allegations, Russian media have reported.

Kerimov family investment firm Bonum Capital subsequently submitted a list of contenders to join the bank's board, the lender and a Bonum Capital representative said last week.

The bid was successful, three sources told Reuters. They did not know the terms of the deal. Representatives from Bonum Capital and representatives of the Ananyev brothers both declined to comment. The terms may see no money change hands at all, two sources close to the bank's leadership told Reuters, on account of the current owners' existing obligations to structures owned by Kerimov.

Representatives of the Ananyev brothers did not reply to requests for comment on whether, after Vozrozhdenie's sale, they would retain the 10 percent stake which they are permitted.

In securing the deal to buy Vozrozhdenie, Kerimov has outrun another major contender.

Russian pension fund Blagosostoyanie, owned by state railway operator Russian Railways, had previously offered the Ananyev brothers a deal which would see Vozrozhdenie merge with the pension fund's Absolut Bank. The merger, which also would not have seen any money change hands, had been under discussion ever since the death of Vozrozhdenie founder Dmitry Orlov in 2015. Russia's No.2 bank, the state-controlled VTB, had also been floated as a contender. —Reuters