Weekly Market Summary

17th of February 2017

Did US President Trump Inherit a Mess or a Solid Economy ?!? Depends on Who You Ask !
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Capping a month packed with controversy - including a contentious immigration order, claims of fake media news and biased intelligence community, a diplomatic crisis with friends and foes alike and the loss of Trump's national security adviser Michael Flynn following reports that he had misled Vice-President Mike Pence about his contacts with Russia – the US President launched yesterday an extraordinary attack on the news media in a wide-ranging, wild 75-minute press conference. The president insisted his team was running "*like a fine-tuned machine*" and ridiculed the mainstream media that he said was peddling "*fake news*". "*I open the paper and I see stories of chaos, chaos*, *but it is the exact opposite*" he said. Trump added that "*he had inherited a mess*" while "*my administration is running like a fine-tuned machine, despite not being able to get my cabinet approved.*"

Earlier in the week, US Federal Reserve Chair Janet Yellen said more interest-rate increases will be appropriate if the U.S. economy meets the central bank's outlook of gradually rising inflation and tightening labor markets (*certainly confirmed by Wednesday's stronger-than-expected CPI and Retail Sales releases, which showed a resilient and buoyant consumer supported by gains in household income and wealth and the sharpest jump in US consumer prices in nearly four years!*). "*At our upcoming meetings, the Federal Open Market Committee will evaluate whether employment and inflation are continuing to evolve in line with these expectations, in which case a further adjustment of the federal funds rate would likely be appropriate*," Yellen told the Senate and House Banking Committee in prepared remarks on Tuesday and Wednesday. It was her first Congressional testimony on the state of the US economy since Donald Trump became president, and the Fed Chair reiterated that falling behind on inflation could harm to the economy and possible cut short the expansion. "*Waiting too long to remove accommodation would be unwise, potentially requiring the FOMC to eventually raise rates rapidly, which could risk disrupting financial markets and pushing the economy into recession.*" Still, Yellen gave no indication of the timing of the next hike in her prepared remarks. Investors see about a 35% chance of a 25 bps increase in the overnight rate at the next FOMC meeting on March 14th-15th. The Fed, which has only raised rates twice since the recovery began in 2009, has penciled in three quarter-point rate increases in 2017, as the economy closes in on the central bank's goals for maximum employment and 2% inflation.

In response to questioning (ensuing Q&A session), Yellen noted that Fed policy makers will be discussing in coming months their strategy for the Fed balance sheet, which swelled to about US$ 4.5 trillion after the crisis from less than US$ 900 billion in 2006 as the central bank sought to hold down long-term market rates. The Fed Chair said she expects the balance sheet to end up being "*substantially smaller*" than it is now, with policy makers wanting to shrink in an "*orderly and predictable way*." The Fed doesn't want to use the balance sheet as an active policy tool and it should eventually be comprised primarily of U.S. Treasuries.

Moving to Europe, we amusingly learned on Thursday that the European Central Bank (ECB) is willing – once again - to fudge the rules in its mission to restore price stability (*central bankers' manipulation at its best!).* An account of the last policy meeting revealed that officials see a deviation from the capital key -- a measure intended to link quantitative easing to the relative sizes of the 19 euro-area economies -- as "*inevitable*." That is because sticking strictly to the key means having to go after bonds that are in short supply -- and that anyway yield so little that they lock in a loss for the ECB. While divergences were also considered "*limited and temporary*," investors took it as a sign that the ECB will buy more bonds from heavily-indebted and weaker nations - read Italy & Spain - and fewer from countries such as Germany. That could in turn stoke the fury of critics who would argue the ECB is assisting one government at the expense of another and undermining the case for economic reform.

Staying in Europe, Greece and its creditors have intensified efforts to complete a stalled review of the nation's bailout that would unlock much-needed aid before more than 6 billion euros (US$ 6.3 billion) in obligations come due next July. EU Commissioner for Economic Affairs Pierre Moscovici met with Greek Prime Minister Alexis Tsipras and Finance Minister Euclid Tsakalotos in Athens on Wednesday to try to reconcile differences over what reforms are needed to stabilize the country's economy. European rescue monitors had wanted a deal reached by February 20th when Euro-area finance ministers gather in Brussels to discuss the matter. But Greece has remained at odds with its bailout creditors - the European commission, the ECB, the European Stability Mechanism and the IMF – who have proposed further fiscal cuts equal to 2% of its gross domestic product, including a lower tax-free threshold and pension reforms. In return, the Greek government will be able to reduce some taxes or social contributions if there is fiscal over-performance. Athens has denied that such a deal is being discussed and its prime minister has reiterated that his government will not pass a single euro of additional austerity! And whilst the International Monetary Fund (IMF) has taken a more severe stance on Greece's economic projections and what remedies are required to make its debt sustainable, European Union nations including Germany and the Netherlands have deemed the Washington-based fund's participation necessary (One Chaotic European bloc !!)

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