BANKING ON KNOWLEDGE

Divergent policies of advanced economies contribute to currency volatility

By Dr R Seetharaman

US dollar edged lower last Friday on signs that US tax reforms could be delayed after Senate Republicans offered a plan that differed significantly from the House of Representatives' version.

US Republican senators said they wanted to slash the corporate tax rate in 2019, later than the House's proposed schedule of 2018, complicating a push for the biggest overhaul of US tax law since the 1980s.

The dollar ended last week at 94.391 and had fallen by close to 8% this year. Early of this week, the dollar received a lift against its major peers as US yields spiked and as the pound stumbled, although the main investor focus was still on a planned US tax overhaul.

The euro was at $1.1665 and has surged by close to 11% this year. The single currency has risen in recent times as a result of a mixture of bold 'public relations' exercises from European central banker Benoit Coeure, who said the recovery in the eurozone is the strongest he has seen in 20-years, and hard data from the European Commission which revised up its estimates for growth in 2017 to 2.2% from only 1.7%.

The pound was at $1.3196 and has surged by close to 7% this year. Pound climbed to its highest since the Bank of England's interest-rate increase earlier this week, after Brexit Secretary David Davis and his European Union counterpart Michel Barnier said they would work with the goal of moving talks on to trade next month.

The currency was also supported last Friday by better-than-forecast industrial data, and an estimate from the National Institute of Economic and Social Research that suggested economic growth had accelerated in October. However, earlier this week the pound slipped as troubles mounted for British Prime Minister May.

The yen was at 113.53 against the US dollar by end of last week and had strengthened by close to 3% this year. A worse-than-expected US consumer sentiment and possible delay in US tax reforms gave some strength to the yen.

The Swiss franc was at 0.9961 against the US dollar by end of last week and had strengthened by more than 2% this year. The franc had strengthened recently on account of global equity sell-off, which spurred the appetite for safe haven assets.

The Australian dollar was at 0.7687 by end of last week and had strengthened by more than 6% this year. However, it fell

last week on account of weak consumer price index (CPI) results which also raised doubts when the Reserve Bank would finally announce an interest rate hike, in keeping up with the US, the UK, and other recovering global economies.

The Indian rupee was at 65.1663 against the US dollar by the end of last week and had strengthened by more than 4% this year. The Indian rupee slipped in the early trade this week.

The Russian rouble was at 59.1593 against the US dollar by end of last week and had strengthened by close to 4% this year. The surging oil prices gave a boost to the Russian rouble.

The Chinese yuan was at 6.6409 against the US dollar by end of last week and had strengthened by close to 4% this year. The combination of improving economic data in China and the ongoing weakness in investment sentiment towards the dollar is encouraging for the yuan.

The Brazilian real was at 3.2837 against the US dollar by end of last week and was flat year to date.

The South African rand was at 14.3773 against the US dollar by end of last week and had weakened by close to 5% this year. The rumours of free education and ratings downgrades put pressure on rand in recent times.

In October 2017, the European Central Bank halved its asset purchase stimulus programme, to €30bn per month, for another nine months. But the ECB also left little doubt that it intends to keep buying bonds for even longer in an attempt to get inflation.

In October 2017, the Bank of Japan opted to keep its ultra-loose monetary regime intact but cut its outlook for inflation, saying that stronger growth is not yet doing enough to push wages higher or fire up consumer demand.

US President Donald Trump, earlier this month, chose Jerome Powell to become the next head of the Federal Reserve, the US central bank, when the current Fed chair Janet Yellen's term expires in February 2018.

Despite three rate hikes by the Fed, dollar weakness still prevails. The central bank has raised rates a notch twice in 2017 and is widely expected to do so again next month from its current target range of 1.00% to 1.25%.

The Bank of England (BoE) raised interest rates for the first time in more than 10 years in November 2017. It projected "very gradual" further increases over the next three years.

The divergence in monetary policies in advanced economies contributes to currency volatility.

■ *Dr R Seetharaman is Group CEO of Doha Bank.*