Weekly Money Market Report
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A Long Trek Ahead for Interest Rate Hikes

Highlights

- **The resilience of the US economy and consumer sentiment show no signs of giving up, keeping the Federal Reserve unapologetically hawkish.**
- **A sense of hope lingers in the Eurozone with the latest data pointing to a possibly milder economic contraction while neighboring United Kingdom witnesses more economic gloom.**
- **Bank of Japan (BoJ) stunned markets with a surprise tweak to its bond yield controls, allowing long-term interest rates to rise more.**
- **The dollar held steady closing the week at 104.325.**

United States

Shrugging Off Inflation & Interest Rates

The resolute resilience in the US economy is showing no signs of being battered or disheartened. Even though the recent bag of data came in mixed, it still shows an overall robust and growing economy. The final GDP reading in Q3 this year was revised upwards unexpectedly from 2.9% to 3.2%. Driving the growth was strong exports and healthy consumer spending. As for the job market, applications for US unemployment benefits were little changed last week. Rising by just 2K to reach 216K, it sticks near a historically low level and underscores businesses' reluctance to lay off workers in a supply-constrained labor market. The job market is still extremely tight despite some signs of cooling and the ongoing imbalance between labor supply and demand continues to put upward pressure on wages. In one sign that the Federal Reserve's persistent rate hikes are serving their purpose by slowing the economy, sales of existing US homes shrunk by 7.7% in November, marking the 10th straight month of decline as high mortgage rates stifle affordability. In another, the Fed's favored gauge of inflation, the Core Personal Consumption Expenditures (PCE) Price Index rose more modestly in November by 0.2% month-on-month and 4.7% from a year ago in line with expectations. The pace of growth slowed down from last month's 0.3% rise and annual rate of 5%.

Nevertheless, with inflation easing and gasoline prices dropping to the lowest since mid-2021, Americans are feeling better about the economy. Consumer confidence in December rose to the highest since April following back-to-back monthly declines. The Conference Board Consumer Confidence Index increased to 108.3 up sharply from 101.4 in November. The Present Situation Index—based on consumers' assessment of current business and labor market conditions—increased to 147.2 from 138.3 last month. The Expectations Index—based on consumers' short-term outlook for income, business, and labor market conditions—improved to 82.4 from 76.7. However, expectations are still lingering around 80, a level associated with recession.

With data hinting that price pressures may have peaked and markets speculating a pause from the Federal Reserve's interest rate hikes ahead, hawkish sounds intensified. The Fed has made it very clear that with annual headline inflation still running above 7%, it is far too soon to let off the gas on interest rates. Central bank officials vowed to keep raising rates until they are confident inflation is coming down. The Fed's economic projections appeared to incorporate an assumption that inflation would prove resurgent at the end of this year and officials expect core inflation to end 2022 around 4.8%, up from the 4.5% figure they forecast in September.

The US Dollar regained itself after getting caught off guard this week from the Bank of Japan's monetary policy meeting. Fed hawkishness and a strong economic backing kept the dollar steady at 104.325 and major peers' gains limited.

Europe & United Kingdom

Optimism Rains in the Eurozone

In a sign that price pressures are slowly being doused, producer prices in Germany decreased by 3.9% month-on-month in November, the second time prices declined significantly compared with a month earlier, thanks to the developments to lower energy prices.

On the sentimental side, a sense of hope is flowing across Europe. Germany's business outlook in December improved for a third month amid signs that double-digit inflation may be peaking and a deep recession over the winter can be avoided. The country's most prominent leading indicator, the ifo Business Climate survey, rebounded to 88.6 this month from 86.4 in November. Germany was among the countries reporting slower inflation in November as pressure from surging energy costs receded. Well-filled gas-storage facilities have also lowered the likelihood that Russia's war in Ukraine will lead to disruptive shortages in the coming months. Another survey, the German GfK Consumer Climate Index also rose for the third time in a row to -37.8 from -40.1, thanks to moderating energy prices and the German government's relief packages to curb energy costs. Nevertheless, stormy recession clouds are hovering nearby. Despite some relief in global supply chain frictions, early leading indicators from Asian nations point to potential weakening in global trade in the coming months along with the next chapter of the pandemic in China unfolding which may affect trade. Finally, elevated energy prices are gradually being passed on to consumers, a trend which will continue throughout next year and therefore may weigh on private consumption. Although a European recession still looks likely, the data flow is increasing the prospect of a shallower than expected contraction.

On the political side, nations of the European Union (EU) ended months of political wrangling and reached a deal over whether to intervene in the energy crisis that risked pushing the region into a recession. The EU decided to cap gas prices at €180 per megawatt-hour, which will apply for one year starting February next year, as a temporary measure designed to prevent extreme price swings. The cap is much lower than the earlier proposal, which would have not prevented the spikes that the region saw earlier this year when Russia curbed gas supplies during its war in Ukraine.

On the fiscal side, like their American counterparts, European Central Bank (ECB) officials kept up the hawkish talk. ECB Vice President Luis de Guindos said the central bank will raise interest rates until projections show that unprecedented regional price gains are headed back to the 2% target. Guindos suggested another 50bps on the table at the next ECB meeting early in February. Governing Council Member and Germany's Bundesbank President Joachim Nagel also stressed the need to increase rates given it will take some time until inflation slows to the central bank's 2% target.

The single currency held steady in the 1.06 region, ending the week at 1.0618.

No New Year Cheer in the UK

The British economy is falling deeper into contraction when the revised GDP for Q3 this year was downwardly revised, falling by 0.3% instead of the first estimate of falling by 0.2%. During the third quarter, the services sector grew by 0.1% while the production sector fell by 2.5%. Compared with pre-Covid levels, services output is now 1.3% below its Quarter 4 (Oct to Dec) 2019 levels, revised down from previously 0.9% below. Production output has now contracted for five consecutive quarters since Quarter 3 2021. The manufacturing and construction sectors were the hardest hit and real household disposable income continues to fall amid rising inflation. Annual real GDP is now estimated to have increased by 7.6% from 2020 to 2021, revised from the previous estimate of 7.5%. However, despite an upward revision to annual growth in 2021, downward revisions across the quarters of 2022 mean that real GDP is now estimated to be 0.8% below its pre-Covid level, revised from the previous estimate of being 0.4% below.

Strengthening headwinds and recessionary forces gaining momentum capped the cable at 1.2062.

Asia-Pacific

The Ultradove Strikes in Japan

The Bank of Japan (BoJ) stunned markets at their latest monetary policy meeting last week. While keeping the interest rate at rock bottom and unchanged at -0.10%, the BoJ adjusted its yield curve control policy much sooner than expected. The yield control target was kept at 0% for the 10-year bond, but the yield trading band was widened to 0.50%, double the previous limit of 0.25%. As rising inflation rates pile pressure to the upside, raising the cap on Japanese government bond yields means Japanese debt can pay higher interest rates. The BoJ also said it would significantly increase its bond purchases to ¥9 trillion ($67.5 billion) per month compared with the currently planned ¥7.3 trillion per month. Governor Haruhiko Kuroda argued that the purpose was to improve liquidity in the bond market and enhance the sustainability of monetary easing. However, many investors are seeing it as the first step towards policy normalization. Some are even suggesting that the BoJ could raise rates some time next year.

Japanese inflation data continues to jump higher despite Governor Kuroda's claim that is transitory and temporary. Core CPI, which excludes food but includes energy costs, hit a 40-year high of 3.7% annually in November as companies continued to pass on rising costs to households. Another core measure that excludes both food and energy also rose 2.8% annually in November from 2.5% in October. The figures entail how inflationary pressures are seeping into the broader economy.

Markets reacted sharply after the BoJ yield curve control policy move. The 10-year yield jumped to 0.46% from 0.25% after the decision. The yen strengthened to as much as 132 against the dollar, compared with 137.16 immediately before the meeting, and ended the week at 132.79.

Diminishing Appetite for Hikes in Australia

According to the minutes of the Reserve Bank of Australia's (RBA) latest meeting earlier this month, three options were considered – 25 basis points, 50 basis points, or a pause – before the 25bps rate hike was chosen and implemented. This is the first time during the RBA's eight-month tightening cycle that board members put the case for no change on the table. The RBA decided against it in recognition that the latest incoming economic data did not yet warrant a change of stance. Nonetheless, the consideration of a pause indicates that they could be close to stepping on the brakes. In deciding to keep tightening, the board members noted that the central bank's most recent forecasts indicated that inflation was expected to take several years to return to the 2-3% target, even with further increases in the cash rate. To provide themselves maximum flexibility to maneuver in their current cycle, the RBA reiterated that it expects to continue to increase rates while adding that they "are not on a pre-set path." The size and timing of future hikes will continue to be determined by incoming data and the outlook for inflation and employment. The minutes showed that members saw "considerable uncertainty" for the economic outlook both locally and globally and the timing and extent of a likely slowdown in household spending is still unknown. The board also acknowledged that the rate hikes have yet to fully seep into the economy and cause some pain, as a large number of households are still on fixed mortgage rates and unaffected by the rapid tightening to date.

The aussie jumped back and forth the edges of 0.6700 and ended the week at 0.6719.

Kuwait

Kuwaiti Dinar

USD/KWD closed last week at 0.30605.

Rates – 25th December, 2022

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.0596	1.0587	1.0635	1.0618	1.0400	1.0800	1.0683
GBP	1.2045	1.2020	1.2094	1.2062	1.1900	1.2300	1.2084
JPY	132.32	132.13	133.14	132.79	133.00	138.00	131.13
CHF	0.9306	0.9284	0.9346	0.9333	0.9200	0.9500	0.9237

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