Weekly Money Market Report
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Non-Transitory Inflation Becomes Enemy No.1 for Major Economies

Highlights

- **Federal Reserve announces it will double the pace at which it will taper it's bond-buying program**
- **President Biden increases the debt ceiling, which should keep the government from defaulting till 2023**
- **Bank of England becomes the first major central bank to hike interest rates since the pandemic started**
- **The Sterling Pound is the strongest gainer this week followed by the safe-haven Swiss Franc**
- **European Central Bank announces it will taper one of its two quantitative easing programs**
- **Crude has shed off much of its gains amid a surge in omicron cases and tightening of major central banks**

The last central bank meetings for the year saw plenty of hawks spread their wings with the likes of the Federal Reserve (Fed) accelerating tightening plans, the Bank of England (BoE) hiking rates, and the European Central Bank (ECB) announcing tapering in its Pandemic Emergency Purchasing Program while doubling its bond-buying in the Asset Purchasing Program. Central Banks are forced to prioritize the fight against non-transitory elevated inflation by tightening monetary policies. Therefore, these decisions will likely impact global equities, debt markets and forex markets.

United States

Federal Reserve's Tapering

The US Federal Reserve announced it will cut back its stimulus program quicker than expected as it responds to inflationary pressures. Stimulus will now be reduced by $30bn a month instead of $15bn starting in January. The decision entails stimulus ending by March 2022, opening the door to an interest rate hike in the first half of next year. "Economic activity is on track to expand at a robust pace this year, reflecting progress on vaccinations and the reopening of the economy," said Fed chair Jerome Powell. "In my view, we are making rapid progress toward maximum employment," he added. Officials now forecast inflation will run higher next year than previously projected and that unemployment would fall to 3.5%. Consequently, they forecast that benchmark interest rates would rise from the current near-zero levels to 0.9% by the end of 2022.

Debt Ceiling

Joe Biden signed a debt ceiling bill proposed by Congress. The debt ceiling will be raised to $2.5 trillion, therefore allowing the US government to meet its obligation until 2023. The increase of the debt ceiling ensures the US will not default as it inches close to economic peril.

Economic Indicators

US retail sales rose by less than expected in November. The data suggests consumers are easing purchases amid the fastest inflation in decades. Overall, retail sales increased 0.3% following a 1.8% gain in October. Excluding volatile items, sales climbed 0.2% in November.

US producer price index (PPI) topped economists' forecasts as it increased 9.6% from a year earlier and 0.8% from the prior month. The 9.6% annual increase in prices paid is close to a record high. The core PPI, which excludes the volatile food and energy components increased by 0.7% from the prior month and set an annual increase record of 7.7%. The cost of production has rapidly increased due to transportation bottlenecks, robust demand, material costs and labor shortages. The PPI is a forward looking indictor, therefore this annual increase in PPI will likely sustain a pipeline of inflationary pressures well into 2022.

EU & UK

European Central Bank

In the European Union, the European Central Bank (ECB) has announced it will gradually reduce its Pandemic Emergency Purchasing Program (PEPP) by boosting the Asset Purchase Program (APP), in order to smoothly taper the ECB's quantitative easing. The ECB has two different quantitative easing programs, the APP and PEPP. The APP is a securities buying program that was implemented in 2015 and the purpose was "to support the monetary policy transmission mechanism and provide the amount of policy accommodation needed to ensure price stability" as stated by the European Committee on Economic and Monetary Affairs (ECON). The rollout of the APP was due to deflationary risks that occurred in the euro area around 2014 when a drastic fall in oil prices pushed inflation down. In 2014, inflation was lower than the worst of the Great Recession of 2009. The APP was supposed to end in 2016, however it kept getting extended and it came in favor of the ECB when the pandemic hit in 2020. However, there was rising tensions during the pandemic on the sovereign debt market that forced the ECB to rollout the PEPP in order to be "conducted in a flexible manner regarding the allocation across countries" as stated by ECON.

The difference between the APP and PEPP is that the APP is a long-term solution to boost economic activity during a deflationary period, whereas the PEPP is a short-term solution to counter the pandemic hit economy in different EU countries. ECB President Lagarde announced that the PEPP is set to end by March 2022 and in order to ease the transition the APP will double to 40 billion euros. The APP will be tapered down to 30 billion euros in the 2Q2022 before returning to the existing pace of 20 billion euros in October 2022. The decision was to counter the euro area's fastest inflation rise since the introduction of the single currency.

Bank of England

In the United Kingdom, the Bank of England (BoE) is the first major central bank to announce a rate hike since the pandemic. The BoE has raised its borrowing cost by 15 basis points to 0.25%. BoE governor Andrew Bailey emphasized that inflation was behind the surprise decision for the rate hike when he stated "We've seen evidence of a very tight labor market and we're seeing more persistent inflation pressures, and that's what we have to act on". This remarks a shift in tone for the BoE similar to the Federal Reserve stating that most inflation pressures are non-transitory and will likely to continue well into 2022. Markets are currently pricing in another 20 basis points of increase in February, with Bloomberg Economics stating "worries about inflation trumped concerns about omicron at the BOE's December meeting….assuming the virus doesn't slow down the economy materially, we expect the next move in May, although there's a small risk the BOE hikes again in February".

Although, the BOE's rate hike comes as a surprise for investors, nonetheless this decision is in line with Bailey's guidance and was signaled back in October when Bailey stated that the rates would be hiked to address inflation. However, the surprise for investors was due to the mounting uncertainty over the economic impact and clouded outlook set by the Omicron variant. Nonetheless, the BoE felt compelled to respond to the 5.1% inflation figures that came in November.

Market Movement

On the forex front, the US dollar index hit a weekly low of 96.042 following the Fed's announcement of doubling the tapering pace. The single currency is barely finding support to remain within the 1.1300 level against the greenback. The sterling pound is the strongest gainer for the week following the BoE rate hike. The sterling pound is followed by the Swiss Franc as the second strongest gainer in the week as it benefits from its safe-haven status amid mixed data and interpretation of the overall market.

Commodity-linked currencies like the Canadian were amongst the worst performing as the crude market took a shift in momentum due to the clouded outlook presented by the omicron variant.

Moving to Wall Street, equities have whipsawed this week as investors and traders attempt to price in prospective Fed rate hikes while assessing the risks and surge of the omicron variant. Most stocks fell on Friday due to economic risk from the highly transmissible omicron variant and the Fed's announcement of tapering which soured sentiment.

Moving to the debt market, treasury yield curve steepened after the Federal Reserve announced it will increase the pace at which it will reduce its bond buying program. The yield on 10-year treasuries witnessed an advance of one basis point to 1.42%.

Finally the commodities complex, the crude market witnessed a shift in sentiment due to growing concerns about the demand outlook that is clouded by the omicron variant and tighter monetary policies from major central banks. On the other hand, as a safe haven commodity, gold has gained momentum with an increase of 0.70% as it is being traded around $1,800 an ounce.

Kuwait

Kuwaiti Dinar

USD/KWD closed last week at 0.30270.

Rates – 19th December, 2021

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.1315	1.1220	1.1360	1.1239	1.1025	1.1430	1.1266
GBP	1.3235	1.3170	1.3374	1.3242	1.3030	1.3415	1.3244
JPY	113.25	113.12	114.26	113.67	111.65	115.55	113.53
CHF	0.9207	0.9173	0.9294	0.9237	0.9085	0.9375	0.9210