Weekly Money Market Report
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Higher and more Persistent Inflation Corners Central Banks

Highlights

- **Last week's FOMC minutes outlined plans for interest rate hikes and balance sheet reductions after expressing worry over elevated inflation. Minutes were less hawkish than expected and markets did not react strongly.**
- **US producer prices rose double the expected level in January, rising 1% on a monthly basis and 9.7% on a yearly basis. The figures followed last week's data which revealed 40-year record CPI growth.**
- **Retail sales in the US bounced back in January despite high inflation and the spread of Omicron, rising 3.8% for the month versus the 2.1% estimated.**
- **In the UK, consumer prices reached a 30-year high of 5.5% while the core figure rose to a record 4.4% in January just ahead of an increase in energy costs and taxes due in April.**
- **Australia's labor market continues to prove its strength even amid the spread of the Omicron variant, unexpectedly adding almost 22k jobs in January.**

All signs now point to stronger and broad-based gains in inflation with no signs of slowing down after both the US CPI and PPI report for January ran well above expectations. Pipeline inflationary pressures are mounting alongside higher commodity prices, global trade disruptions, and price increases in key inputs to production which are dragging overall prices higher. Price pressures are also coming from strong wage gains amid a tightening labor market. Hopes that inflation would shift away from goods to services as the pandemic ebbs and supply chains normalize are simply not materializing. Inflation now sits at 7.5% in the US, 5.1% in the Eurozone, and 5.5% in the UK. The US Federal Reserve will likely have no other option but to respond aggressively at the next meeting in March, suggestive of a 50bp interest rate hike.

Last week, the greenback ended slightly lower against its peers as risk sentiment fluctuated, with the euro and sterling closing the week at 1.1325 and 1.3594 respectively. Commodity currencies such as the Australian dollar and Canadian dollar maintained support as oil prices remain above $90. Moving to bonds, yields dipped lower across the board though remain higher YTD with 2-year and 10-year returns last seen sitting at 1.47% and 1.93% respectively. On Wall Street, the S&P 500 ended the week 1.44% lower after dropping 1.9% the week earlier.

United States

FOMC Minutes

During last week's meeting, Federal Reserve officials outlined plans for interest rate hikes and a reduction in asset holdings on their balance sheet as concern mounted regarding inflation and financial stability. Minutes revealed FOMC members noted inflation was spreading beyond pandemic-affected sectors and is seeping into the broader economy. Some officials expressed concern that loose monetary policy could be posing a substantial risk, indicating interest rate hikes are likely on the way soon and an unwinding of the bond portfolio may be aggressive. Most participants said rates should rise at a faster pace than 2015 which was no surprise to markets since the Fed waited a full year in 2015 in between tightening.

After weeks of market hype on soaring inflation and a hawkish Fed, markets found the tone of the latest minutes less hawkish relative to expectations. Markets were especially on edge after St. Louis Fed President James Bullard caused traders to price in the equivalent of seven 0.25% rate hikes this year – pricing that has since eased after the meeting minutes release. The January meeting solidified market expectations that the

Fed was on track to raise interest rates in March, speculation now is on how quickly and by how much. PPI & retail sales data released later in the week continued to support calls for rate hikes.

Strong PPI Acceleration

Data last week revealed US producer prices rose double the 0.5% level expected in January as inflation ran at a 40-year high. The PPI index - which measures prices at the wholesale level – increased 1% for the month and a 12-year high of 9.7% on a yearly basis. Excluding volatile items such as food, energy, and trade services, the core figure climbed 0.9% for the month versus the 0.4% estimated and 6.9% for the 12-month period.

When comparing these figures to the record levels hit in December 2021, both core and headline PPI gains are just 0.1% lower in January and remain strongly elevated. As a common theme throughout much of the Covid-19 pandemic, prices for goods outweighed those for services, rising 1.3% and 0.7% respectively. Final demand for energy prices jumped 2.5% in January, while food climbed 1.6%.

Robust price gains across the board will reinforce inflationary concerns that the Fed is expected to battle this year with monetary policy. Following two years of unprecedented accommodation by the US central bank, interest rate hikes are expected to begin in March and continue throughout the year. Markets are now pricing in up to 7 rate hikes for the year.

Strong Retail Sales

Alongside rising inflation and the Omicron variant, American consumers kept spending. Retail sales bounced back in January with the figure rising 3.8% for the month versus the 2.1% estimate. Excluding auto, sales rose 3.3% after falling 2.8% in the previous month. The rise illustrates an economy with plentiful jobs, sizable wage gains, and consumers with cash to spend at the start of 2022. However, spending patterns have become less predictable. While holiday shopping would normally push retail sales higher in December and lower in January, this year experienced the exact opposite. It is important to note that the data is not adjusted for inflation which will continue to boost the sales figures for months to come.

UK

Inflation Climbs to 1992 High

British consumers saw prices rise to 5.5% in January, marking the fastest annual pace of inflation in nearly 30 years and beating economists' forecasts for a 5.4% gain. Core inflation, which excludes volatile prices, rose to its highest on record at 4.4% in January from 4.2% in December. Shortly after the release of the inflation data, two-year British government bond yields hit their highest levels since 2011.

Households have been warned to expect a squeeze on their living standards after the nation's energy regulator announced a 54% increase in gas and electricity prices in April that will affect 15 million households – the same month that income taxes are set to rise by 1.5%.

Unlike its peers, the Bank of England has already raised rates twice since December 2021 to 0.5% from 0.1%. Financial markets expect a further increase to 0.75% or 1% after the central banks next meeting. Earlier this month, the BoE predicted inflation would peak at around 7.25% in April 2022 after household energy bills are due to rise by more than half. The central bank does not expect inflation to return to its 2% target until early in 2024, while many economists see inflation falling faster.

Australia

Labor Overcomes Omicron

Underscoring the resilience of Australia's labor market, the economy unexpectedly added 21,900 jobs in January while the jobless rate held at a 13-year low of 4.2% in the face of Omicron spreading fast across the nation. Most notable was the 8.8% drop in time worked in areas which saw the sharpest spikes in Covid such as NSW and Victoria. Meanwhile in Western Australia which maintained its border restrictions, time worked increased by 1.7%. Despite the overall better than expected data, Australian bonds advanced as the weakest addition to jobs in three months held back bets on the RBA's rate-hike timing.

The robust strength of the labor market heavily supported market bets that the RBA would begin raising rates in the coming months. In contrast, Governor Philip Lowe estimates it will take some time for low unemployment to translate into faster pay gains, suggesting tightening is still far off. The RBA expects unemployment to drop below 4% this year, however wage growth is only seen lifting slightly to 3% in 2023. Expectations that the Reserve Bank would hike rates in May dropped to 60% from 80% following the release of the data.

Commodities

Ukraine-Russia Border Crisis

Oil prices briefly touched $95 last week as investors digested developments on the Russia-Ukraine crisis. Meanwhile, the safe-haven metal gold reached $1,900 before retreating slightly. At a time when global supply is already struggling to keep up with demand, investors have been exceedingly sensitive to the risk that an invasion of Ukraine would disrupt Russia's vast energy supplies.

President Joe Biden expressed skepticism about Russia's claims of removing troops. The President said he believes an invasion of Ukraine could happen "within the next several days", while the US secretary of state warned the UN that Russia is planning to manufacture a justification for an attack and has not withdrawn troops. Similarly, NATO Secretary General Jens Stoltenberg said Wednesday that despite "signs from Moscow" that diplomacy should continue, "we do not see any sign of de-escalation on the ground." Investors were calmer after Friday's reports of planned talks between the US and Russia which provided relief prior to the weekly closing.

Kuwait

Kuwaiti Dinar

USD/KWD closed last week at 0.30245.

Rates – 20st February, 2022

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.1343	1.1278	1.1395	1.1321	1.1120	1.1545	1.1360
GBP	1.3554	1.3483	1.3642	1.3590	1.3395	1.3795	1.3590
JPY	115.26	114.78	115.87	115	113.05	117.05	114.85
CHF	0.9250	0.9186	0.9273	0.9215	0.9010	0.9415	0.9190