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Weekly Money Market Report
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Peak Inflation Potentially Peeks from the Clouds

Highlights

- **Major central banks begin to shift away from jumbo rate hikes as inflation shows potential signs of cresting in the United States, Europe, and Australia.**
- **Rates of contraction in Germany and Italy ease and sentiment improves thanks to a mild winter, sufficient gas storages, and possible deceleration from the Federal Reserve.**
- **Chinese authorities loosen Covid-Zero stringent policies in an effort to extinguish protests and revive a suffering economy.**
- **The Reserve Bank of Australia (RBA) raises interest rates by 25bps to 3.10%, its highest since November 2012.**
- **The dollar rally cools down after softer economic data raises bets of the Fed decelerating.**

United States

Lifting a Foot off the Accelerator

While inflation dynamics on a larger scale have shown some improvement, parts of the US economy refused to slow down. Surge in business activity pushed the ISM Services PMI to 56.5, the highest level since 2021. The firmer services reading contrasts with ISM's manufacturing data, which showed factory activity contracted for the first time since May 2020 last week. Thirteen services industries reported growth in November, led by real estate, rental and leasing, mining, and agriculture, forestry, fishing and hunting. In October, factory orders rose 1% month-on-month, beating the 0.7% expectation and much higher than the previous month's 0.3% rise. Producer prices in November rose by more than forecast, driven by services and underscoring the stickiness of inflationary pressures. The producer price index climbed 0.3% month-on-month (7.4% year-on-year) while core producer prices (excluding food and energy) rose 0.4% month-on-month (6.2% year-on-year).

The labor market did show some signs of cooling and raised a potential flag of recession. Unemployment claims rose by 4K to 230K last week, in line with expectations, suggesting that those who are losing jobs are having more trouble finding a new one.

Beyond the improvement in the inflation dynamics in the US, Federal Reserve officials seem to accept that a slower pace of rate hikes is appropriate. After four consecutive 75 basis point hikes, the Fed looks prepared to downshift to a 50 basis point hike at their meeting next week. Economists surveyed by Bloomberg expect rates to be held at their peak of 4.9% throughout next year, reflecting a 4.75-5% range and dashing forecasts for cuts in the second half. According to the survey, interest rates are expected to be cut to 4% by June 2024 and to 3.5% by the end of 2024.

The Treasury market flashed growing recession fears after data indicated softness in growth. The 10-year Treasury yield stood at 3.58% and the 2-year Treasury yield stood at 4.34%. The greenback turned slightly downward after markets digest an eventual deceleration in the Federal Reserve's hiking cycle. The US Dollar Index traded in the 104-105 range throughout the week, closing at 104.932.

Europe

Hopes Spread for a Milder Recession

Spirits across the Atlantic are lifted. To start the month, the latest Sentix Investor Confidence Index surprisingly improved to -21 from -30.9, its highest level since June this year. Hope flowed thanks to mild winter weather, sufficient gas in storage and a possible peak in inflation data. Also, internationally, there seems to be more moderate tones from the Federal Reserve and protests in China seem to point to an end to the restrictive Covid measures.

In Europe's largest economy, Germany, factory orders posted a sizeable surprise to the upside, rising above the consensus expectations of 0.1% month-on-month growth to 0.8% month-on-month in October. Much of the growth has been driven by large-scale orders, without which would have sent orders to a decline of 1.2% on the month. On an annual basis though, the October figure represents a 3.2% fall in orders. On a more positive note, industrial production fell less than the expected 0.6% decline, falling by 0.1% month-on-month in October.

In Europe's third largest economy, Italy, the rates of contraction in the service sector and retail sales eased. In November, the Services PMI Index improved from 46.4 to 49.5, against an expected 47.6. In October, Italian retail sales dipped 0.4% compared to forecasted 0.6% decline. The better-than-expected data adds to hopes that the Eurozone may be poised for a milder recession than previously anticipated.

Appetite at the European Central Bank (ECB) to lift rates by 75 basis points for a third straight time appears to be waning after data last week showed regional inflation slowing from a record high. Despite the likelihood of a smaller increment, prices that are still surging five times the 2% target of the ECB, the cycle of increases is set to push into 2023. ECB's Governing Council member Constantinos Herodotou said borrowing costs will rise again, though interest rates are now close to the level where monetary policy is neither expansionary nor restrictive. ECB's Chief Economist Philip Lane said inflation is close to cresting, while also acknowledging that borrowing costs will be raised again.

The single currency traded between 1.0500 and 1.0590 this week, closing at 1.0534.

Asia-Pacific

Pressure Produces Concessions to Protesters in China

In a sharp change in national strategy to extinguish public discontent and fire up the economy again, Chinese authorities loosened stringent Covid restrictions. The National Health Commission set out ten new measures to assist the move away from Covid Zero, which include accelerating vaccination among the elderly, allowing some people to quarantine at home, and scrapping PCR tests to enter public venues.

China's Politburo, the Communist Party's top decision-making body, said it will seek a turnaround in the economy next year, pledging to keep fiscal policy active and monetary tools targeted. Officials will "push for overall improvement of the economy" by focusing on the quality of growth and keeping the pace of expansion reasonable, while seeking to boost market confidence. On monetary policy, the Politburo stuck to its description that measures will be "prudent, and added that it should be "targeted and forceful." That came in contrast to the language in the People's Bank of China (PBOC) report last month, which said monetary policy will be "flexible and appropriate."

The initial rally of optimism faded as focus turned into the release of the latest Chinese data that came in weak. The ongoing implementation of Covid containment measures dampened performance of the service sector and the overall economy. The latest Caixin Services PMI came in short of expectations and short of last month's performance. In line with expectations, Chinese price growth is still weak. Consumer prices in November came down from October's reading of 2.1% year-on-year to 1.6% year-on-year and core inflation remained unchanged at 0.6% year-on-year in November. Producer prices remained in deflation for a second month in November, coming in at 1.3% year-on-year.

Covid Fallout Recovery Lacks Vigor in Japan

In a better-than-expected start to the final quarter of the year, Japan's economic decline was revised upwards in the third quarter compared to the previous report, as domestic demand turned out to be slightly stronger. Real gross domestic product (adjusted for inflation), shrank by 0.2% on a quarterly basis, revised upward from minus 0.3%. In addition, Japanese households boosted spending by 1.2% in October from a year earlier. However, a separate report showed that despite total cash earnings rising 1.8% in October from a year ago, price inflation pushed real wage growth deeper into negative territory. Japan's real wages, a key indicator of consumers' purchasing power, dropped by 2.6% from the year earlier, the sharpest contraction since 2015.

The solid spending data suggests that for now, the release of pent-up demand continues to support the country's recovery path even as inflation eats into households' purchasing power. The government's travel

subsidies to revive the tourism industry contributed to consumption as well. Nevertheless, broadening price hikes propelled by a weak yen in the backdrop of weak wage growth could rein in expenditure. Falling real pay , coming in a long way from Bank of Japan's (BoJ) Governor Haruhiko Kuroda's wage hopes, highlights households' growing burden and policymakers' challenge. Governor Kuroda has maintained that paychecks need to grow at around 3% to get the central bank to budge on interest rates.
The yen traded between 135.50 and 136.90 this week, closing at 136.56.

Inflation Heat Cools Down in Australia

The Reserve Bank of Australia (RBA) raised its cash rate by 25 basis points to 3.1%, its highest level since November 2012. After eight consecutive monthly hikes, the latest decision brought the RBA's cumulative hikes since May to 300 basis points, the sharpest annual tightening since 1989. In continuation to combatting the hottest inflation in three decades, policymakers expect to tighten further. "The board expects to increase interest rates further over the period ahead, but it is not on a pre-set course," RBA Governor Philip Lowe said in his statement after the meeting, "The size and timing of future interest rate increases will continue to be determined by the incoming data." Justifying a more hawkish RBA stance has been the strong A$2.2 trillion ($1.5 trillion) economy, a resilient local jobs market, and large savings built up during the pandemic in the face of rapid rate increases.

Solid household consumption continues while the rate increases have yet to fully filter through the economy. Economic expansion moderated in the third quarter. GDP in Q3 rose by 0.6% (5.9% annually), short of the 0.7% (6.2% annually) growth expected. On one hand, it is the fourth consecutive quarter of growth. On the other hand, it marks the weakest growth over the past year. The moderation in activity validates the RBA's decision to slow the pace of policy tightening. According to the RBA's forecasts, GDP is expected to continue trending lower to 2.9% at the end of this year, then to 1.4% in 2023 through to 2024.

The aussie traded between 0.6740 and 0.6810 this week, closing at 0.6797.

Commodities

Oil Juggles Multiple Variables

OPEC+ responded to surging volatility and growing market uncertainty of supply and demand in the coming months by keeping its oil production unchanged. The oil producers' group has only just implemented the hefty 2 million barrel-a-day reduction agreed at its last gathering in October. However, OPEC+ did maintain an interventionist tone, saying that it was ready to "meet at any time and take immediate action to address market developments," in their statement.

From another angle, the European Union (EU) approved a price cap level on Russian oil of $60 a barrel to limit revenues to Russia's government. In parallel to the price cap, EU sanctions on imports of Russian crude oil came into effect adding another market that will be closed off to Russian exporters. In response to the cap, Russia may either impose a fixed price for their barrels or stipulate maximum discounts to international benchmarks at which they can be sold.

Oil markets are highly sensitive to how China progresses in its easing of its Covid-Zero policies. While recession worries across major economies will keep the outlook into next year cloudy, a Chinese economy reviving would represent tightening of the oil market. WTI closed the week at $71.02 a barrel and Brent crude closed the week at $76.10 a barrel.

Kuwait

Kuwaiti Dinar

USD/KWD closed last week at 0.30690.

Rates – 11h December, 2022

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.0561	1.0508	1.0590	1.0534	1.0400	1.0700	1.0601
GBP	1.2238	1.2208	1.2326	1.2259	1.2100	1.2500	1.2286
JPY	136.65	135.59	136.59	136.56	135.00	138.00	134.89
CHF	0.9363	0.9310	0.9381	0.9343	0.9200	0.9500	0.9243