Weekly Money Market Report
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Treading the Tight Line between Tackling Inflation and Avoiding Recession

Highlights

- **Inflation jitters, tighter monetary policy, and lockdowns in China provoked economic growth concerns and sent stocks and bonds tumbling. Government yields soared around the world as investors braced for a wave of policy tightening by central banks.**
- **The Reserve Bank of Australia surprised markets with a larger-than-expected 25bp hike, while the Fed delivered a 50bp-sized rate hike not seen since 2000 and the Bank of England's 25bp boost marked its fourth consecutive rate hike.**
- **The dollar stayed strong against its major peers, hammering the euro, sterling, and yen to all-time lows.**

United States

Let the Hikes Begin

The Federal Reserve deployed its most aggressive tightening policy in decades upon delivery of a 50bp rate hike, taking the federal funds rate to a range of 0.75% to 1%. The move marked the first time the Fed delivered a hike this size since 2000 and boosted rates at consecutive meetings since 2006. The 50bp rate hike was favored unanimously and Fed Chair Jerome Powell flagged future rate hikes at that pace, nixing a more worrisome and larger 75bp rate hike for the time being.

The Fed also announced it would begin trimming its $8.96 trillion balance sheet next month. The balance sheet reduction is to happen in phases, allowing a capped level of proceeds from maturing bonds to roll off each month while reinvesting the rest. Starting June, the Fed will begin declining its holdings of Treasuries and mortgage-backed securities at a combined monthly pace of $47.5 billion ($30 billion in Treasuries and $17.5 billion in mortgage-backed securities) for three months, which will then pick up to $95 billion ($60 billion in Treasuries and $35 billion in mortgage-backed securities).

"Inflation is much too high and we understand the hardship it is causing and we are moving expeditiously to bring it back down," Chair Jerome Powell said, maintaining his confidence in the Fed's ability to pull off a soft landing for the American economy.

The US Economy Chimes On

Despite the latest quarterly GDP figure shrinking by 1.4% in the first quarter as higher prices begin to bite, the US economy did not show signs of any material slowdown. Although figures fell, activity in both the manufacturing and service sectors are above the thresholds that indicate growth. Softening growth in orders, production, and employment sent the ISM Manufacturing PMI unexpectedly dropping in April to 55.4, the lowest level since 2020, compared to 57.1 last month. The ISM Service PMI also dropped in April to 57.1 compared to 58.3 last month but recorded growth for the 23rd month in a row. The labor market remains in robust health. April non-farm payrolls matched last month's figure and beat estimates, adding 428K jobs while the unemployment rate held at 3.6%. On a brighter note, average hourly earnings grew, but less than expected rising by 0.3% instead of the estimated 0.4%.

Markets took a sharp U-turn after rallying the most since May 2020 celebrating the results of the Fed meeting and safety assurances from a 75bp rate hike. Solid US jobs growth and wages remain an enduring source of inflationary pressures. The Dow Jones, S&P 500, and Nasdaq all closed the week in the red and the 10-year Treasury yield shot back above 3%. The US Dollar index climbed to just under 104, its strongest level since 2002 before fluctuating after the data release, ending the week at 103.66. Despite the decline, it still remains the winner against its peers.

Europe

Operation Stagnation

Europe just narrowly avoided slipping into a recession in its ongoing battle with inflation, war, and supply chain issues conspiring to drag the region's economy down. German GDP grew 0.2% last quarter compared to last quarter's 0.3% decline. However, the outlook of the German's economy darkened in recent weeks as the manufacturing sector suffered from input shortages and record price pressures caused by the war. Factory orders in Germany dropped by 4.7% in March, much higher than the anticipated 1% drop and the previous month's 0.8% drop, reflecting disruptions to global supply chains and the lack of access to the Russian market, a key export destination for German firms. German joblessness in April fell by 13K only, its slowest pace in a year compared to an 18K drop in the previous month, pointing to labor market vulnerabilities as the war in Ukraine and surging inflation weigh on Europe's largest economy. European Union proposals to restrict their reliance on Russian energy supplies will be a headwind on growth this year as alternative sources of energy will take time acquainting with the region's economy.

Inflation in the Eurozone continues to be driven mainly by energy prices, which are 38% higher in April than they were a year ago. Price pressures in the region were unveiled as monthly PPI figures in April rose by 5.3% compared to 1.1% in the previous month, and exceeded expectations of 4.9% increase.

Pause for Thought

The European Central Bank's (ECB) monetary policy timeline has been complicated by the spillover from the war in Ukraine. It already signaled it will terminate quantitative easing in the third quarter, after which interest rate hikes will be considered. However, the latest economic data and its go-slow approach that is beginning to contrast its major peers may coerce the ECB to move sooner. Germany's 10-year Bund yields rose above 1% for the first time since 2015, closing the week at 1.13%.

The euro tumbled, demoralized by an increasingly concerning economic outlook and persisting geopolitical complications. After breaking below 1.0500 for the first time since 2016, it collapsed to 1.0483 before closing the week at 1.0555.

United Kingdom

Pessimistic Blues Linger

The Bank of England (BoE) raised rates by 25bps at its May meeting, taking the rate from 0.75% to 1%, a level not seen since 2009. The BoE begun shrinking its balance sheet in February, originally at £875 billion by ending gilt reinvestments, allowing £28 billion to roll off. However, they put off a decision this meeting on actively selling from its currently £847 billion balance sheet until later this year, coming at odds with market expectations.

The overcast on the British economy is the most gloomy yet, with BoE forecasts warning double digit inflation and a prolonged period of stagnation or potentially even a recession. Inflation is set to climb above 10% in October, due to another increase of about 40% in the UK's energy price cap. British households are facing a 1.75% drop in real disposable income this year, the second biggest fall since 1964, even after government support measures to ease the cost of living crisis. This year, pay growth is set to rise 5.75%, sharply higher than the February outlook, before falling in 2023 and 2024. Unemployment is expected to drop this year before climbing to 5.5% by 2025. The economy will continue to stagnate into 2024, growing a feeble 0.25%.

The sterling drowned to a 22-month low even after the rate hike as it struggled to shake off worries on the economic outlook, hitting 1.2277 before closing the week at 1.2341. The trigger was the warning of recession as high inflation hurts real incomes of households and businesses.

Asia-Pacific

A Surprise Guest on the Hiking Trek

The Reserve Bank of Australia (RBA) surprised markets after delivering a bigger rate hike than expected this month. The cash rate was pumped by 25bps, taken from 0.15% to 0.35% against an anticipated 15bps hike. In addition, maturing proceeds of its A$621 billion balance sheet will not be reinvested, in a bid to shrink its balance sheet. The RBA signaled more rate hikes are forthcoming and updated its inflation forecasts. Inflation is expected to hit 6% this year, compared to 5.1% in Q1 2022 and projected to fall back to 3% by 2024. Growth is set at 4.25% this year and 2% next year. Yields on the benchmark 10-year government notes jumped to their highest since November 2014 after the decision, and closed the week at 3.46%.

The dismissal of a 75bp rate hike from the Fed was taken well by the aussie, which managed to get the spotlight for its own rate hike. The aussie rose above 0.7250 before retreating to 0.7079 as the dollar regained its strength.

China Suffocates under Lockdown Measures

Economic activity contracted sharply in April as a series of lockdowns to contain the rapidly-spreading virus closed factories and snarled supply chains, taking a significant toll on the economy. Both manufacturing and services activity plunged to their worst levels since February 2020. The Caixin Manufacturing PMI fell to 46 compared to 48.1 last month and Caixin Services PMI fell to 36.2 compared to 40.1 last month. There are no signs of easing lockdown measures but the nation's top leaders continue to provide sweeping pledges to boost economic growth. In avoidance of quantitative easing throughout the crisis, China opted for stimulus mode with targeted measures aimed at providing funding for smaller businesses and reviving a wounded property sector.

Japan Still Wedded to Asset Purchases

The Bank of Japan (BoJ) is still the standout and remains committed to monetary easing, scaling bonds in the recent weeks to defend rock bottom bond yields from exceeding 0.25%. Unlike its Western peers, Japan struggles with anemic inflation, which has kept the BoJ an outlier as it continues to provide stimulus and keeps very low interest rates in place. The Japanese yen suffered immensely from this sharp divergence in policy, weakening to its lowest level in 20 years and slipping more than 10% against the dollar so far this year, trading above 130. The break through the 130 mark has rumbled speculation that Japan may consider intervening in markets to support its currency.

Commodities

The Commotion Continues

The latest EU embargo on Russian oil that raised the prospects of tighter supply shrugged off demand worries from China, sparking the oil rally. Ignoring calls from Western nations to boost output, OPEC+ members stuck with its plan to raise its June output target by 432K barrels per day only. WTI closed the week $109.77 a barrel and Brent closed $112.39 a barrel. Gold wallowed under pressure of the dollar and the global wave of rate hikes, closing the week below $1,900 an ounce.

Kuwait

Kuwaiti Dinar

USD/KWD closed last week at 0.30640.

Rates – 8th May, 2022

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.0546	1.0483	1.0602	1.0555	1.0380	1.0650	1.0602
GBP	1.2366	1.2277	1.2383	1.2341	1.2150	1.2450	1.2343
JPY	130.17	130.08	130.80	130.56	129.60	132.25	130.02
CHF	0.9847	0.9825	0.9892	0.9887	0.9790	1.0080	0.9834