Weekly Money Market Report
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Powell Warns Inflation "Too High" in Jackson Hole Speech

Highlights

- **Last week, the group BRICS announced to have invited six nations, most of which are from the Middle East, to join their bloc.**
- **US Fed Chair Jerome Powell delivered his remarks at the Jackson Hole Symposium, warning that inflation is still running "too high", raising the prospect of further interest rate increases should price pressures persist.**
- **US manufacturing and services PMIs both decelerated in August, with the composite index dropping to 50.4 from 52 in July, just above the 50-level separating growth from contraction.**
- **Unemployment claims in the US fell last week by 10,000 to a seasonally adjusted 230,000 for the week ending August 19th. Continuing claims also decreased by 9,000 to 1.702 million.**
- **Germany's ifo business climate index declined to 85.7 in August versus the 86.7 expected. The economy stagnated in the second quarter.**
- **Eurozone PMI's are pointing to broad weakness, complicating matters particularly for the European Central Bank.**
- **In China, the central bank trimmed its one-year loan prime rate by 10 basis points, marking the second cut in just three months. Still, the action was less aggressive than markets had expected.**

Jackson Hole: Powell Warns of Further Hikes

The highly anticipated speech by Fed Chair Jerome Powell at the Jackson Hole Symposium resembled remarks he made last year, during which he warned that "some pain" was likely for the Fed to bring inflation back down. However this time around, annual inflation is running at 3.2% versus the 8.3% level in August 2022, allowing room to alleviate fear in markets.

Powell called for more vigilance in the fight against rising prices, warning that additional interest rate increases may be needed. Although he acknowledged slow and healthy progress has been made, he added that inflation is still above where policy makers feel comfortable and provided little indication that the central bank will ease up anytime soon. "Although inflation has moved down from its peak — a welcome development — it remains too high," Powell said. "We are prepared to raise rates further if appropriate, and intend to hold policy at a restrictive level until we are confident that inflation is moving sustainably down toward our objective." He also pushed back on speculation that the Fed could raise its inflation target, an idea that has been hotly debated mostly by academics in recent months. "Two percent is and will remain our inflation target," he said.

The US economy grew at a 2.4% annualized pace in the second quarter, a surprisingly robust reading that drove many economists to boost forecasts for the third quarter and reconsider odds of a recession. Despite data running largely in the Fed's favor, Powell noted it was too soon to declare victory. "The lower monthly readings for core inflation in June and July were welcome, but two months of good data are only the beginning of what it will take to build confidence that inflation is moving down sustainably to our goal," he said.

In summary, the highly anticipated remarks are in-line with Powell's rhetoric so far in 2023: Focus is on price stability, and further tightening remains on the table to get inflation back to 2%.

Market Reaction

Bond yields rose and stocks fluctuated after Jerome signaled the Fed will keep policy tighter for longer. The dollar gained ground on Friday, with the index ending the week 0.62% higher, sending the euro and pound to close the week at 1.0804 and 1.2580 respectively. The yield on the US 2-year Treasury bond shot above 5%

while the 10-year yield ended the week at around 4.24%. Markets are now widely expecting the Fed to keep interest rates on hold at their September meeting. Moving forward, expectations are split between another 25 bps hike or no change for the November and December meetings.

BRICS Group Expansion
Last week, BRICS announced to have invited six nations to join the group at its Summit in Johannesburg, most of which are from the Middle East. The group was originally formed in 2009 with India, Russia, Brazil, and China and then it first expanded to include South Africa in 2010. More recently, the group took a huge leap in its expansion by inviting Argentina, Egypt, Ethiopia, Iran, Saudi Arabia, and the United Arab Emirates to join starting next year. The expansion comes at a time when Russia and China are locked into rising tensions with the West.

Russian President Vladimir Putin congratulated the new BRICS members, adding that he “would like to assure all our colleagues that we will continue the work that we started today on expanding the influence of BRICS in the world,” the Russian president added. China’s President Xi Jinping called the bloc’s expansion “historic,” reflecting its determination to “unite and cooperate with developing countries.” In Saudi Arabia, the foreign minister added that the bloc had “proven itself to be a useful and important channel to strengthen economic cooperation with countries of the so-called Global South.” Bin Farhan told the BRICS conference earlier Thursday that the kingdom would continue to be a “secure and reliable energy provider,” adding that total bilateral trade between Saudi Arabia and BRICS nations exceeded $160 billion in 2022.

The bloc’s expansion is raising the question of potential de-dollarization, a process in which members gradually switch to using other currencies to conduct trade. And although analysts say it is unlikely, BRICS countries have also been talking about a common currency.

United States

Business Activity Approaches Stagnation
According to S&P Global, the US manufacturing and services PMIs both decelerated in August. The manufacturing PMI dipped to 47 from 49, while services lost ground but managed to grow, falling to 51 from 52.3. The flash Composite PMI index, which tracks both sectors, fell to a reading of 50.4 in August from 52 in July, representing the biggest drop since November 2022. "A near-stalling of business activity in August raises doubts over the strength of U.S. economic growth in the third quarter. The survey shows that the service sector-led acceleration of growth in the second quarter has faded, accompanied by a further fall in factory output," said Chris Williamson, chief business economist at S&P Global Market Intelligence.

While the figure marks seven straight months of growth, it was only fractionally above the 50-level separating expansion from contraction. The data painted a more tepid picture of the economy after fears of a recession were brushed off due to a strong labor market and robust consumer spending.

Labor Market Remains Tight
The number of Americans filing for unemployment claims fell last week by 10,000 to a seasonally adjusted 230,000 for the week ending August 19. Meanwhile continuing claims, or the number of people receiving benefits after an initial week of aid, decreased 9,000 to 1.702 million during the week ending August 12. In comparison to historical standards, continuing claims remain low, indicating laid-off workers are experiencing short periods of unemployment.

The labor market continues to defy expectations in the face of the Fed’s aggressive interest rate hikes, as employers hold on to workers after struggling to find labor during the Covid-19 pandemic. Labor market strength accompanied by receding inflation continues to provide optimism that the economy could avoid a recession.

Europe & UK

German Business Sentiment Worsens
Business morale deteriorated more than expected in Germany, falling for the fourth month in a row according to a survey released on Friday. The Ifo institute reported its business climate index stood at 85.7, down from 87.4 in July, while analysts had forecast a reading of 86.7. Assessments of the current situation fell to their lowest level since August 2020 and companies’ expectations for the next six months were also increasingly

pessimistic. Europe's largest economy stagnated in the second quarter following a winter recession. Moving forward, stubbornly high prices and a lack of demand from foreign trade will continue to weigh on the economy in the last two quarters.

PMI's Point to Weakness in Manufacturing and Services across Europe & UK

Euro zone business activity declined more than expected in August, particularly in Germany, complicating matters for the European Central Bank which is still aiming to control price rises without causing a recession. The flash Composite Purchasing Managers' Index for the bloc dropped to 47 in August from July's 48.6, it's lowest since November 2020. The figure is well below the 50-mark separating growth from contraction. Activity in Germany contracted at the fastest pace in more than three years as a worsening downturn in manufacturing was accompanied by a renewed contraction in services. In France, the dominant services sector contracted further as drops in demand and new orders hinted at a contraction. Britain's economy also followed suit, with manufacturing easing to 42.5, reaching its lowest since May 2020.

Asia

PBOC Less Aggressive than Market Expectations

The People's Bank of China trimmed its one-year loan prime rate (the peg for most household and corporate loans) by 10 basis points from 3.55% to 3.45%, marking the second cut to the rate in just three months. However, the central bank left its five-year loan prime rate (the peg for most mortgages) unchanged at 4.2%, despite economists' expectations for a 15 bps cut due to worsening liquidity issues in the country's property sector. The PBOC said China will coordinate financial support to resolve local government debt risks and reduce systemic risks, while also looking to "adjust and optimize" credit policies for the property sector and lower financing costs for the economy.

The recovery in the world's second-largest economy lost steam due to a worsening property slump alongside weak consumer growth and sinking credit growth – forming a classic case for more policy stimulus. On the other hand, downward pressure on the yuan leaves little room for deeper monetary easing which would further widen China's yield differentials and may trigger yuan selloffs. So far this year, the yuan lost nearly 6% against the USD, becoming one of the worst performing Asian currencies.

Kuwait

Kuwaiti Dinar

USD/KWD closed last week at 0.30785.

Rates – 27th August, 2023

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.0876	1.0764	1.0930	1.0804	1.0700	1.1200	1.0852
GBP	1.2731	1.2546	1.2800	1.2577	1.2400	1.2800	1.2582
JPY	145.33	144.53	146.63	146.41	144.00	148.00	144.30
CHF	0.8816	0.8758	0.8876	0.8845	0.8870	0.9000	0.8762