Weekly Money Market Report
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Cooling US Wage Growth Calms Rate Hike Concerns

Highlights

- **The latest Federal Open Market Committee's (FOMC) meeting minutes showed that officials are still committed to the fight against inflation and expect higher interest rates to remain until further progress in lowering inflation is made.**
- **US Nonfarm payrolls slowed last month but still managed to beat expectations. However, wage gains grew more modestly, indicating cooling inflation.**
- **The slowdown in wage growth fueled expectations of a less hawkish stance by the Fed, fueling a dollar sell-off across the board. The dollar index reached a high of 105.63 only to lose most of the week's gains and close at 103.911.**

United States

FOMC Minutes Indicate Rates to Remain High for Some Time Ahead

The latest Federal Open Market Committee's (FOMC) meeting minutes showed that officials are still committed to the fight against inflation and expect higher interest rates to remain until further progress is made. Members expressed the importance of maintaining their current restrictive policy while inflation remains excessively high. The minutes reflect the sentiments shared by Jerome Powell in his press conference after the FOMC raised rates by 50 basis. The increase, which took the target range for the benchmark to 4.25%-4.5%, its highest level in 15 years, ended a streak of four consecutive three-quarter point rate hikes.

Policymakers also expressed their concern about financial markets misinterpreting their commitment to fighting inflation, as the minutes reiterated that "it would be important to clearly communicate that a slowing in the pace of rate increases was not an indication of any weakening of the Committee's resolve to achieve its price stability goal." In the longer run, Fed officials have projected that interest rates would rise to just over 5% by the end of 2023. Meanwhile, markets are currently pricing a possibility for rates to increase by a total of 0.5 - 0.75 percentage points in the coming months before dropping in the second half of the year towards a range of 4.5%-4.75% despite the Fed's forward guidance.

The minutes also highlights that members see the risk of easing too soon and risking higher inflation to outweigh the risks of maintaining its restrictive policy for too long and slowing the economy too much.

Along with the rate hikes, the Fed has been reducing the size of its balance sheet by allowing up to $95 billion in proceeds from maturing securities to roll off each month rather than be reinvested. In a program started in early June, the Fed has seen its balance sheet contract by $364 billion to $8.6 trillion.

Labor Market Remains Strong yet Lighter Wage Gains Indicate Cooling Inflation

While some of the recent inflation metrics have shown progress, the labor market, a critical target of the rate increases, has been resilient. US Nonfarm payrolls slowed last month but still managed to beat expectations. Nonfarm payrolls increased by 223,000 for the month, above estimates for 200,000, while the unemployment rate fell to 3.5%, 0.2 percentage point below expectations. The job growth marked a small decrease from the 256,000 gain in November. Wage growth was less than expected highlighting that inflation pressures could be weakening. Average hourly earnings rose 0.3% for the month and increased 4.6% from a year ago. The respective estimates were for growth of 0.4% and 5%.

Moreover, the number of Americans filing new claims for jobless benefits dropped to a three-month low of 204,000 in the last week of December and job openings increased to 10.458 million in November, which translates to 1.74 jobs for every unemployed person. Additionally, private payrolls also beat expectations and increased by 235,000 jobs last month after rising by 182,000 in November. Economists had expected the ADP National Employment report would show an increase of only 150,000 private jobs.

The reports highlight the strength of the labor market at the end of 2022, despite a burst of layoffs in the technology industry as well as in interest rate-sensitive sectors like finance and housing.

Market Reaction

The dollar performed well against its major counterparts before the US Jobs report on Friday, as the FOMC minutes indicated that rates would remain elevated for a longer period than anticipated. Yet the slowdown in wage growth fueled expectations of a less hawkish stance by the Fed, fueling a dollar sell-off across the board. The dollar index reached a high of 105.63 only to lose most of the week's gains and close at 103.911. Meanwhile, the euro and the British pound managed to recover from their week lows and recoup most of their losses. The Euro recovered from 1.0482 to close at 1.0647, while the pound jumped from 1.1838 to a high of 1.2096. Similarly, the Japanese yen appreciated dramatically and pushed the pair to a low of 132.07.

Furthermore, equities rallied and US treasury yields dipped on Friday as signs of cooling inflation calmed worries of the Federal Reserve's rate hike trajectory.

Manufacturing and Services PMI

US manufacturing contracted further in December, but weakening demand amid higher borrowing costs pushed a measure of prices paid by factories for inputs to the lowest level in more than 2.5 years, signaling that goods disinflation was underway. The Institute for Supply Management (ISM) said last week that its manufacturing PMI dropped to 48.4 last month from 49.0 in November, contracting for a second straight month. That marks the weakest reading since May 2020.

Meanwhile, services activity contracted for the first time in 2.5 years in December, while the prices paid by businesses slowed considerably, offering evidence that inflation was abating. The Institute for Supply Management's (ISM) non-manufacturing PMI dropped to 49.6 last month from 56.5 in November. It was the first time since May 2020 that the services PMI fell below the 50 threshold, which indicates contraction in the sector that accounts for more than two-thirds of U.S. economic activity.

Outside the COVID-19 pandemic slump, this was the weakest services PMI reading since late 2009. The index is also now below the 50 level, which the ISM says over time is consistent with a recession in the broader economy.

Europe & UK

Eurozone Inflation Slides Amid Cooling Energy Prices

Euro zone inflation fell last month but underlying price pressures are still rising and economic growth indicators are surprisingly benign, suggesting that the European Central Bank (ECB) will keep raising interest rates for months to come. Headline inflation, which includes food and energy costs, came in at 9.2% year-on-year in December. It follows November's headline inflation rate of 10.1%, which represented the first contraction in prices since June 2021. However, the core figure which excludes volatile food and energy prices, picked up to 6.9% from 6.6%. Fighting a historic surge in prices, the ECB has since July increased borrowing costs at its fastest pace on record. It has promised a string of further moves this year to curb inflation that its own economists see staying above its 2% target well into 2025.

UK PMI's Paint a Bleak Picture Ahead

The situation continues to worsen in the UK as economic activity ended 2022 on a weak note. The Final Manufacturing PMI fell to a 31-month low of 45.3 in December, down from the November reading of 46.5. This reading is regarded as one of the weakest since mid-2009 and marks the sixth consecutive month of contraction in the sector. Meanwhile, service activity remained in contractionary territory at the end of 2022. Activity was down marginally, whilst new business fell at its weakest rate for three months. Cost pressures also showed signs of weakening, with inflation rates down for both operating expenses and charges. Nonetheless, price pressures remain elevated, and the business environment challenging. UK's Final Services PMI was revised lower to 49.9 from its flash reading of 50.0, indicating a slight contraction in the sector. Nevertheless, the figure marks an improvement from the previous reading of 48.8.

Kuwait

Kuwaiti Dinar

USD/KWD closed last week at 0.30625.

Rates – 8th January, 2023

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.0524	1.0484	1.0650	1.0647	1.0515	1.0950	1.0709
GBP	1.1916	1.1842	1.2103	1.2096	1.1990	1.2460	1.2119
JPY	133.40	131.98	134.77	132.07	129.45	133.40	130.44
CHF	0.9357	0.9268	0.9408	0.9273	0.9080	0.9405	0.9181