Weekly Money Market Report
14 February 2021

Powell: "Large or Sustained" Inflation Outbreak is Unlikley

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Highlights

- The US Consumer Price Index advanced 0.3% m/m - boosted by higher gas prices. Meanwhile, the core figure was unchanged m/m, increasing 1.4% y/y.
- US Federal Reserve Chairman Jerome Powell attempted to ease inflation worries, reiterating the central bank's commitment to support the economy "until the recovery is complete."
- The greenback ended the week lower, while stocks on Wall Street ended higher. The GBP/USD pair broke the 1.39 level to a near 4-year high.
- UK GDP suffers worst decline since the "Great Frost" of 1709. The COVID-19 driven recession is the worst among major economies.
- According to economic forecasts, the EU faces a difficult road ahead. Nevertheless, vaccination programs and lower reporting of COVID-19 cases provide a "light at the end of the tunnel."

United States

Muted Inflation

Last week, it was revealed that the key measure of US inflation was unchanged in January for a second straight month. The core figure (which excludes volatile food and energy costs) increased 1.4% from the prior year though was unchanged m/m. The broader CPI advanced 0.3% m/m, boosted by higher gasoline prices. The data comes during a time of intense debate among economists regarding the course of inflation moving forward. While the relatively tame figures were weaker than expected, inflation is for the most part expected to move higher in the months ahead. Expectations that Congress will pass another large stimulus package alongside a pickup in demand as more get vaccinated against COVID-19 supports this theory.

Hence, the concern is in regards to the pace of the rise in inflation. If higher rates come into play soon, it would damage stock valuations which are currently trading near record highs due to a lack of competition from bond yields. More importantly, the cost of debt would rise exponentially at a time of record debt in the US and on a global scale. The US budget deficit (how much more the government spends than it receives in revenue annually) rose to $3.1 trillion in 2020. To put this into perspective, prior to the pandemic the 2020 deficit was projected at $1.1 trillion. Meanwhile, lawmakers are continuing to debate the size of the next COVID-19 relief bill, with President Joe Biden's proposal of a $1.9 trillion plan worrying economists who warn it could spur an outbreak in inflation. On the other hand, others argue there is plenty of room for fiscal stimulus and fears of increases in price pressures are not a concern.

Moving forward, inflation figures may be distorted due to the recession which led CPI to plummet in March, April, and May of 2020. When annual figures are calculated this year, inflation will appear to accelerate quickly y/y compared with those three months.

Powell: Inflation Likely to Remain Subdued

US Federal Reserve Chair Jerome Powell has said the central bank will continue to support the economy "until the recovery is complete." Speaking to the Economic Club of New York last week, Powell said "You could see strong spending growth, and there could be some overt pressure on prices," He added, "My expectation would be that will be neither large nor sustained. Inflation dynamics will evolve but it's hard to make the case why they would evolve very suddenly in this current situation." Furthermore, the Fed has voiced its willingness to let inflation run above its 2% objective for a period of time – an indication policy makers will probably leave interest rates near zero for a while. The struggling labor market also plays a big role here, as persistently high unemployment will limit the degree of the rise in CPI.

Labor Market: Layoffs Remain High Despite Improvement

Unemployment claims are continuing to decline as COVID-19 restrictions recede and activity picks up. Last week's figure decreased by 19,000 to 793,000 - declining for four weeks in a row now. The improving situation has prompted states like California and New York to relax prior restrictions specifically on indoor dining and other activities. However, industries such as leisure and hospitality remain under pressure. Challenges remain for the nearly 10 million Americans who remain unemployed, and the Labor Department's recent reporting of just 49,000 jobs added in January is a grim reminder of what can be expected regarding the pace of recovery.

President Joe Biden's relief package includes an extension of emergency jobless benefits introduced at the start of the pandemic, which are due to expire in March. Fed Chair Jerome Powell stressed the importance of "patiently accommodative" monetary policy to support the struggling labor market. He added that it would "not be easy" for the economy to achieve full employment and that we are still "very far from a strong labor market".

Markets React

US stocks are ending another broadly positive week with the S&P 500 index and Dow Jones Industrial Average ending 1.23% & 1.00% higher respectively. Equities have continuously touched record highs with investors powered by record amounts of stimulus and hopes that COVID-19 vaccines will result in a rapid recovery. The greenback declined last week, sending the GBP/USD above the 1.38 mark to its highest level since April 2018.

Looking at safe-havens, the price of Gold continued to move lower as Treasury yields moved higher. The price for the safe-haven metal has dropped 2.4% so far in February following a 2.7% decline in January. This has correlated with a significant rise in longer-term Treasury yields. The yield difference between the 30-year and 5-year bond is at the widest since 2015, while the gap between the 2 & 10 year reached its widest since 2017.

Europe & UK

UK Economy: COVID-19 Wipes Out Growth

The UK economy suffered its largest economic slump in more than three centuries as GDP plummeted nearly 10% in 2020. Essentially, this has wiped out all growth in the UK over the last 7 years with the economy now back to its 2013 size. Though the 9.9% drop in GDP was less severe than expected, it surpassed the collapse of the 1921 Great Depression, marking the worst annual drop since the 1709 "Great Frost". The recession is one of the worst among major economies. For example, Germany held up a lot better with provisional estimates suggesting a 5% contraction for 2020. The EU is expected to have shrunk 6.4%, while the US fared even better with GDP decreasing by 3.5%.

On a positive note, preliminary GDP figures saw an increase of 1% in Q4 of 2020, providing some signs of improvement following record growth in Q3. However, the national lockdown imposed on January 5 is once again expected to hit the economy hard in Q1 of 2021, reversing the return to growth in Q4 of 2020. Adding to the weight on activity is disruption to EU-UK trade following the end of the Brexit transition period on December 31.

Eurozone: A Challenging Winter, but Light at the End of the Tunnel

The EU & euro-area is expected to reach pre-COVID19 levels of output earlier than previously anticipated, according to the European Commission. Projections are for the EU economy as a whole to see growth of 3.7% in 2021 and 3.9% in 2022 following the 6.4% drop last year. Growth is expected to resume in the spring and summer as vaccination programs progress and containment measures ease.

According to the report, some EU member states will be able to fully recover this year such as Latvia, Lithuania, Luxembourg and Poland. Meanwhile, growth in countries such as Germany, France, and Belgium will not be enough to recoup prior losses, and an improvement will probably have to wait until 2022. Estimated numbers for southern countries such as Spain, Greece, and Italy lead to expectations that they will have to wait even longer after plunging 11%, 10%, and 8.8% in 2020 respectively. Looking at EU inflation, the figure is set to increase from 0.3% in 2020 to 1.4% in 2021, before retreating slightly to 1.3% in 2022. Though risks surrounding the forecast are more balanced, they remain highly dependent on the evolution of the pandemic and the success of vaccinations.

Kuwait

Kuwaiti Dinar

USD/KWD closed last week at 0.30230.

Rates – 14th February, 2021

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.2039	1.2020	1.2149	1.2120	1.2015	1.2315	1.2145
GBP	1.3729	1.3681	1.3866	1.3849	1.3740	1.4035	1.3874
JPY	105.35	104.41	105.67	104.92	102.95	106.85	104.78
CHF	0.8992	0.8890	0.9019	0.8918	0.8700	0.9110	0.8890