

# Weekly Money Market Report

15 January 2023



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## Interest Rate Differential Expectations Pressure the Dollar

### Highlights

- Inflation figure drops in the United States from 7.1% to 6.5% on annual basis and sends the dollar plummeting
- Current interest rate probabilities show two hikes (Feb, March) worth 25 basis points each by the Fed and 50 basis points of cuts by year end as well.
- The market is pricing in a hike by the BOJ in April this year and an implied policy rate of +0.20% by year end.
- UK GDP expands on monthly basis by 0.1% in November and postponed an unavoidable recession.

### A Macro View

The World Bank warns of a highly possible recession for the global economy in 2023. After initially forecasting 2023 global growth at 3.0% back in June 2022, the development lender has backtracked and changed expectations to a global GDP growth of 1.7% in 2023, in a figure considered the slowest paced since 1993, bar the 2009 and 2020 recessions. The bank stated that its newly forecasted 0.5% cuts to the heavily regarded US and European economies could very well send the global economy into a recession. Meanwhile, emerging markets and developing economies will be the major losers, as they struggle to cope with slow business investment, weak currencies and heavy debts.

### United States

#### Inflation in the US

Markets were highly anticipating the consumer prices data from the US economy as it would help guide the prospect of the hiking cycle by the Fed. On Thursday, headline consumer prices in the United States fell from 7.1% to 6.5% on annual basis and in line with the market consensus. As for the core inflation figure, it fell from 6% to 5.7% in December. Adding more details to the picture, motor fuel prices dropped by 0.6% on a monthly basis and food prices continued to increase for the 20<sup>th</sup> month in a row by 0.3%. Taking a closer look into core inflation will show a drop in the price index for used cars and trucks by 2.4% on monthly basis which was a key driver to the easing core inflation data.

Federal Reserve officials signaled that they will need to raise interest rates above 5% and keep it restrictive for longer than markets are expecting. Fed official Mary Daly said that she expects the Fed to raise interest rates above 5%. Meanwhile, Fed official Raphael Bostic reiterated the Fed's commitment to fight higher inflation, stating that he sees rates above 5% lasting for "a long time." Markets turned their attention to Federal Reserve speakers Jerome Powell and Michelle Bowman for guidance on the economy and interest rate paths. While Powell offered little guidance on his policy outlook, he stressed the importance of Fed autonomy and independence from political and climate factors, stating that tackling inflation requires "measures that are not popular." U.S equities edged higher after remarks from Chairman Powell. Meanwhile, Fed Governor Michelle Bowman signaled that more interest rate hikes are to come. Bowman added that once they do get to a sufficient restrictive federal funds rate, "it will need to remain at that level for some time."

Following the CPI data, the markets have priced in two hikes each worth 25 basis points in Feb and March taking the fed rate to 5.00%. The market also priced in the first cut of 0.25% as early as November 2023. The upcoming Fed meeting in a couple of weeks should shed more light on the path of interest rates by the central bank given the recent inflation data and tight labor market.

#### Market Movement

On the forex front, volatility and swings were the trading theme following the CPI data release in the US. Initially the markets sold the dollar and the dollar index reached a low of 102.078 before retreating again towards the

103 levels. On Friday the markets took a firmer direction towards shorting the greenback given the expected narrowing interest rate differentials.

Equity markets rallied on the back of easing inflation data and interest rate cut prospects in the US. The Dow Jones gained more than 1,000 points in 1 week.

## United Kingdom

### UK GDP Data

UK GDP expanded by 0.1% month on month in November and surprised economists who expected a drop of 0.2%. The third quarter of 2022 saw a 0.3% contraction, but after a 0.5% expansion in monthly real GDP in October and the surprise 0.1% growth in November, a technical recession (two consecutive quarters of negative growth) appears to have been averted for now. Despite the positive monthly surprise, the Office for National Statistics noted that GDP shrank by 0.3% in the three months to the end of November, and economists said the recession may simply be delayed rather than averted. The cable continued to trade in a range between 1.20-1.2250 throughout the week.

## Asia

### CPI Spikes in Japan

Further east, Tokyo's inflation excluding food hit 4% in December for the first time since 1982. Tokyo inflation is a leading indicator of the nationwide trend, and the faster pace suggests prices are running hotter than the BOJ's projections. The figures are the last key price data before the central bank meets again next week to decide on policy and update its inflation forecasts. The Japanese yen is gaining major ground on the US dollar as it opened the week at 131.91 and reached a low of 127.45 on Friday as markets reacted to the inflation data in both economies, Japan and the United States. The market is pricing rate hikes by the Bank of Japan starting April 2023 and the implied rate suggest the legacy policy rate of -0.10% would be 0.20% by year end.

### CPI Continues to Surge in China

News continues to come knocking from China, as the world sets its eyes on the integral economy post its long lasting COVID-strict policies. Despite the calm economic activity and the restrained domestic demand, Chinese inflation has increased in December. The latest CPI y/y data shows an increase of 0.2%, from 1.6% in November to 1.8% in December. Meanwhile, the high number of COVID cases disrupted the activity of industry and that was illustrated as prices increased in China. The latest Producer Price Index rose from -1.3% in November, to -0.7% in December, further enhancing inflation figures.

## Kuwait

### Kuwaiti Dinar

USD/KWD closed last week at 0.30570.

### Rates – 15<sup>th</sup> January, 2023

Currencies	Previous Week Levels				This Week's Expected Range		3-Month
	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.0635	1.0634	1.0867	1.0828	1.0600	1.1000	1.0892
GBP	1.2092	1.2085	1.2248	1.2226	1.2000	1.2400	1.2251
JPY	131.92	127.45	132.87	127.88	126.00	129.00	126.32
CHF	0.9274	0.9165	0.9352	0.9265	0.9100	0.9400	0.9175