Weekly Money Market Report

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No Vacation for Inflation

Highlights

- **Federal Reserve officials pushed back against expectations of a pivot to rate cuts next year after a mixed bag of economic data from the US and the Reserve Bank of Australia (RBA) slowed its hiking pace.**
- **While Europe edges recession with economic activity slowing and inflation skyrocketing, the European Central Bank (ECB) prepares for a likely supersized 75bps hike at their next meeting later this month.**
- **The United Kingdom scraps its massive unfunded tax cut plans after strong backlash from Britain and global peers.**
- **A fragile market mood amid concerns of rapidly rising borrowing costs leading to a deeper global economic downturn, further escalation in the Russia-Ukraine conflict, and hawkish calls from the Fed fueled the US dollar rampage, pummeling peers down.**
- **OPEC+ announced production cuts of 2 million barrels a day, its largest cut since 2020 in efforts to buoy oil prices above $90 a barrel.**

United States

Growth Turbulence

Economic growth concerns are mounting as the Federal Reserve raises interest rates to combat inflation. A gauge of US manufacturing stumbled in September to 50.9, more than a two-year low as orders contracted for the third time in four months. The measure of new orders declined to 47.1, also the lowest level since the early months of the pandemic and an indication that demand is softening. Meanwhile, growth at US service providers remained firm in September, reflecting solid business activity and orders and a measure of prices fell to the lowest since the start of 2021. That suggests demand for services is healthy despite high inflation, rising interest rates, and growing concerns about the economy's prospects. Powering much of this demand is the tight labor market, marked by robust job growth and historically low unemployment. Wage gains, though lagging inflation, are still extremely elevated.

The labor market continues to show signs of strength and remains more resilient than the Federal Reserve may want, despite job creation slowing. The Job Openings and Labor Turnover Survey (JOLTS) survey showed that job openings fell by 10.1M in August, the lowest level since June 2021. Nevertheless, it remains extremely elevated. Private sector non-farm payrolls rose by 208K in September, higher than expected and higher than last month's 185K gain. Total non-farm payrolls rose by 263K, in September also by more than expected while the unemployment rate dropped from 3.7% to 3.5%. Wage gains also remained solid and rose by 0.3% month-on-month (5% year-on-year), hinting at robust labor demand amid rising borrowing costs and tightening financial conditions.

The Fed's Job "Far From Over"

While markets have forecast rate cuts by the end of next year after mixed economic data, Fed officials pushed back and insisted that rates will continue to rise and remain elevated. Federal Reserve Bank of San Francisco President Mary Daly and Fed Atlanta President Raphael Bostic were the latest to bang the drum on the need to keep tightening in place to reduce inflation. Bostic said he favors lifting interest rates to between 4% and 4.5% by the end of this year.

The Fed turned the US dollar into a wrecking ball and no end in sight to the carnage. The market has clearly sided with the dollar which better safe-haven appeal in the backdrop of high uncertainty. Hawkish calls from Fed officials have supported elevated US Treasury bond yields and underpinned the dollar. The US Dollar index closed the week at 112.747.

Europe

Bruised Economies on the Brink of Recession

Economic activity in Europe is dented from rocketing energy prices that continue to fuel and upkeep highly elevated levels of inflation. In August, Eurozone producer prices jumped 5% month-on-month (43.3% year-on-year), the biggest rise since March, while core prices which exclude energy, rose 0.3% (14.5% year-on-year). Retail sales dipped 0.3% month-on-month (2% year-on-year) pointing to the hit in consumer demand from the energy shock caused by the Russo-Ukrainian war and underlining expectations of an approaching recession.

The horizon is only darkening further in the region. Faltering demand in the face of high inflation burdened economic activity in Europe's largest economy. The manufacturing sector in Germany lost more momentum in August with factory orders and industrial output falling short of expectations once again. Factory orders contracted by 2.4% monthly and industrial production by 0.8% due to persistent supply bottlenecks. Rising energy costs pushed import prices by 4.3% in August, the highest since 1974 and retail sales dipped by 1.3%.

Managing a Fragile Currency Area with a War Raging Next Door

The European Central Bank (ECB) has been contending with intensifying inflation as the energy crisis in the region took hold and with the euro weakness spurred by spillovers from aggressive tightening in the US. Minutes from the last ECB meeting in September showed that some policymakers preferred a smaller 50bp hike, despite finally agreeing to a 75bp move. The statement clarified the Governing Council's concern that inflation could get stuck at exceptionally high levels and that the euro depreciation could add to inflationary pressures. Therefore, aggressive policy tightening was needed, even at the cost of weaker growth. “The expected weakening in economic activity would not be sufficient to reduce inflation to a significant extent and would not in itself bring projected inflation back to target,” the accounts said. While there was no agreement to signal a hike of similar magnitude at future meetings, policymakers have already started lining up being another 75bps increase in the 0.75% deposit rate at the meeting later this month.

The euro is still broken below parity even after the latest ECB minutes hinted at more hawkishness ahead. The euro closed the week at 0.9745.

United Kingdom

Enveloped in a Self-Inflicted Financial Crisis

After major market turbulence and howls of criticism from Britain and across the world, the UK government reversed the plan to scrap the top rate of tax paid on incomes over £150,000 ($166,770) from 45% to 40%. The mayhem unleashed by the unfunded tax cut plan wiped billions of pounds off Britain's financial markets, forced the Bank of England (BoE) to intervene to prevent a meltdown in the bond market, while the pound plunged to a record low against the US dollar.

Chancellor of the Exchequer Kwasi Kwarteng is due to announce his medium-term fiscal plan to reassure financial markets about his economic strategy. The announcement will “set out how we plan to get debt falling as a percentage of GDP over the medium term,” he said. “Our focus now is on building a high growth economy that funds world-class public services, boosts wages, and creates opportunities across the country.” Prime Minister Liz Truss added.

The pound has been extremely sensitive and volatile in the recent period. It has been falling despite sharply higher bond yields, typically a sign that markets are concerned about policy credibility. In addition, the dangers of being the slowest-growing major economy next year with the highest inflation rate and biggest current account deficit has been particularly toxic for the pound. It closed the week at 1.1088.

Asia-Pacific

Japan: No Appetite for Interest Rate Hikes

Japanese business confidence remained shaky for three consecutive quarters following the yen's rapid depreciation and worsening global economic outlook. The Tankan survey for manufacturers declined to 8 last month, when a rise to 11 has been expected. There was better news for services, which rose to 14 last month when no change was expected as re-opening the country to tourism boosted sentiment in the sector. Inflation in Tokyo accelerated for a fourth consecutive month to 2.8%, led by gains in foods and goods. This adds to the challenges for the Bank of Japan (BoJ) in communicating its need for inflation-supporting easing. Tokyo data is a leading indicator for nationwide inflation, and if gains are similar for the country overall, inflation could reach 3% in the coming months. The latest wage data indicated that growth in paychecks still lacks the strength needed to budge BoJ Governor Haruhiko Kuroda on policy. Inflation-adjusted real wages dropped 1.7% in August from a year earlier.

Despite inflation being above the BoJ's 2% target for four consecutive months and spreading beyond energy prices, Governor Kuroda reiterated the need for ongoing monetary easing because he views the current cost-push inflation is not sustainable and that price growth will drop below 2% next year from lack of robust wage growth.

The widening divergence in the BoJ's policy stance and other major central banks continue to undermine the Japanese yen. The yen closed the week above the 145 red line at 145.33. Japan's finance minister Shunichi Suzuki said that the government stands ready to intervene in currency markets to prevent deeper losses in the domestic currency.

Australia: A Dovish Surprise

Australia's central bank sprang a dovish surprise by raising interest rates by 25bps only, ending a streak of outsized 50bps increases. The Reserve Bank of Australia raised rates by 2.25 percentage points since May this year, when the cash rate stood at a record low of 0.1%.

Governor Philip Lowe reinforced the commitment to tightening even as he acted on signals that he would do so at a slower pace. "The cash rate has been increased substantially in a short period of time," Lowe said in his statement. "The board remains resolute in its determination to return inflation to target and will do what is necessary to achieve that." Inflation accelerated to 6.1% in the second quarter and is expected to peak just below 8% late this year before decelerating in 2023. Australian policymakers are mindful that the country's household sector is among the world's most indebted and that the nature of variable rates on mortgages means rate hikes are particularly potent. "The board expects to increase interest rates further over the period ahead," Lowe said today, "It is closely monitoring the global economy, household spending and wage and price-setting behavior." So far, Australia's heavily indebted households have shown resilience to rising rates. Job advertisements are still elevated and retail sales grew 0.6% in August, growing for the ninth straight month.

The RBA's decision to slow the pace of policy tightening, along with other macroeconomic factors that have supported the US dollar weighed on the aussie, which closed the week at 0.6368.

Commodities

One Rises, Another Falls

Oil prices held onto gains after OPEC+ agreed to the biggest production cut since 2020 and Russia warned that a proposed oil price cap could lead to reduced domestic output. The alliance agreed to slash production by 2 million barrels a day in efforts to revive plunging prices and defend the oil industries and their own economies from risk of global slowdown. Risks to oil demand growth are skewed to the negative as economies respond to substantially tighter monetary policy, high inflation, and slower economic activity. Adding to the bullish outlook, China issued new quotas for crude imports and fuel exports to boost its economy. WTI closed the week at $92.92 a barrel and Brent closed the week at $103.05 a barrel.

Meanwhile, gold slipped after being whipsawed by changing views on the Federal Reserve's stance and the dollar's advance. It gained almost 4% in the first two trading sessions of the week amid disappointing US data, but fell after fresh figures showed the American economy remains resilient as the Fed kept singing a hawkish chorus. Gold ended the week at $1,694.53 an ounce.

Kuwait

Kuwaiti Dinar

USD/KWD closed last week at 0.30940.

Rates – 09th October, 2022

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	0.9792	0.9727	0.9819	0.9745	0.9950	1.0000	0.9815
GBP	1.1164	1.1056	1.1229	1.1088	1.0800	1.1400	1.1105
JPY	145.12	144.70	145.44	145.33	143.00	145.50	143.67
CHF	0.9904	0.9876	0.9954	0.9942	0.9500	1.0000	0.9842