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Weekly Money Market Report
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Data Paves Way for Smaller Fed Hikes

Highlights

- **US core & overall annual PCE prices climbed the slowest since 2021. Meanwhile, GDP registered an impressive 2.9% quarterly rate for Q4 of 2022.**
- **The euro zone's dominant services sector index rose to 50.7 from 49.8 in December, while the manufacturing index improved to 48.8 from 47.8.**
- **In contrast, the S&P Global composite U.K. PMI, measuring both services and manufacturing, slid to 47.8 in January from 49.0 in December, falling short of a 48.5 forecast.**
- **The Bank of Canada hiked its key interest rate by 25 bps to 4.5%, the highest level in 15 years, while also indicating it would likely hold off on further increase for now.**

United States

Fed's Preferred Measure of Inflation Retreats

The cost of U.S. goods & services rose just 0.1% in December, in yet another sign inflation is cooling off, paving the way for the Federal Reserve to stop raising interest rates soon. In the 12 months through December, the PCE price index increased 5.0% after advancing 5.5% in November. The annual figure marks the smallest increase in 15 months. Excluding the volatile food and energy components, the index rose 0.3% after climbing 0.2% in November. Yearly, the core figure rose 4.4% y/y in December after increasing 4.7% in November. The latest CPI report showed inflation rising at a 6.5% yearly rate in December, slowing sharply since the summer.

Last year, the Fed raised its policy rate by 425 basis points from near zero to a 4.25%-4.50% range, reaching the highest level since late 2007. Financial markets are now pricing in a 25-basis point rate increase at the central bank's next meeting on February 1st. Today, as the Fed downshifts, the European Central Bank and the Bank of Japan have instead picked up the mantle. The ECB is expected to stick to aggressive rate hikes while the BOJ may be ending its era of ultra-loose monetary policy after their surprising December easing of pinning long-term bonds near zero.

Economy Records Solid Growth

The U.S. economy maintained a strong pace of growth in the fourth quarter, backing the case for the Federal Reserve to maintain its hawkish stance for longer. Gross domestic product increased at a 2.9% annualized rate last quarter, the Commerce Department said in its advance fourth-quarter GDP growth estimate. The economy grew at a 3.2% pace in the third quarter versus forecasts of a 2.6% rate. Over the year as a whole, measured from the fourth quarter a year earlier, GDP grew 1%, down sharply from 5.7% growth in 2021. The data is preliminary and will be revised at least twice in coming months.

Solid economic growth came as the strong jobs market and cooling inflation encouraged spending despite fears of a recession. Last year, economic output contracted in the first half, prompting talk of a recession, and later rebounded. The fluctuating pattern was driven by large moves in trade and inventories – the most volatile components in GDP. At present, the post-pandemic recovery has cooled from the hectic pace of 2021, however has proven more resilient in the face of war in Europe, global inflationary pressures, and an aggressive US central bank. Moving into 2023, resilience will continue to be tested as inflation remains high and the Fed remains hawkish.

On a positive note, economists say a recession in 2023 is not inevitable. We are seeing signs of abating inflation even as the unemployment rate remains low. This may allow the Fed to raise rates more slowly, reducing the risk that it will fail to achieve a soft landing.

Market Movements

The US dollar has weakened against peers as the Federal Reserve diminishes as the key driver in currency markets and investors switch focus on the policies of other major central banks. So far, the US dollar index lost 1.5% of its value YTD. The comparatively more hawkish outlook by the ECB & BOJ supported both the euro and yen, which have now returned to their strongest levels since spring 2022.

Moving to Wall Street, stocks remain on track for their best month since July even as the rally eased off in recent days as company earnings trickle out. Looking at oil, crude has recovered from a steep slump at the start of 2023 and liquidity is returning to the futures market. A lot of the optimism is due to Chinese demand countering concerns of a global economic slowdown.

Europe

Return to Modest Growth

The euro zone economy returned to modest growth in December for the first time since June, likely bolstering the European Central Bank's move to raise rates. The S&P Global euro zone composite PMI, which includes manufacturing and services activity, came in at 50.2 in January, up from 49.3 in December and above forecasts of 49.8. The euro zone's dominant services sector index rose to 50.7 from 49.8 in December, while the manufacturing index improved to 48.8 from 47.8, also surpassing forecasts but remaining in contractionary territory.

ECB president Christine Lagarde, said last week: "ECB interest rates will still have to rise significantly at a steady pace to reach levels that are sufficiently restrictive, and stay at those levels for as long as necessary." As the US Fed is expected to slow the pace of rate increases to 25 bps at their next meeting, the ECB will now solidify itself as one of the most hawkish central banks with markets widely expecting a 50 bps hike at their February meeting.

United Kingdom

Activity Contracts

In contrast to the euro zone's business activity revival in January, flash PMI readings from the UK showed the economy contracted at its sharpest rate in two years. The S&P Global composite U.K. PMI, measuring both services and manufacturing, slid to 47.8 in January from 49.0 in December, falling short of a 48.5 forecast. The contraction was the result of strike action, staff shortages, export losses, the cost of living crisis and sharp increases in interest rates all combined to squeeze economic activity.

Canada

Bank of Canada Signals Pause

The Bank of Canada hiked its key interest rate to 4.5%, the highest level in 15 years, while also indicating it would likely hold off on further increase for now. The 25-bps hike was widely expected after the bank lifted rates by 425bps in 10 months to battle inflation, which peaked at 8.1% and was last seen at 6.3% in December. Still, the pace is at more than three times the 2% target. A massive December employment report released earlier this month also stressed the upside risk to wage and price growth. "We are turning the corner on inflation," Bank of Canada Governor Tiff Macklem told reporters. "We are still a long way from our target, but recent developments have reinforced our confidence that inflation is coming down."

In its quarterly Monetary Policy Report, the bank illustrated an economy that is going to stall and could even tip into a recession during the first half of 2023, sending inflation down to around 3% mid-year and back to 2% in 2024. Money markets are already seeing the BOC cutting rates in October, a move Macklem dismissed, adding it was premature discussion.

Kuwait

Kuwaiti Dinar

USD/KWD closed last week at 0.30510.

Rates – 29th January, 2023

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.0858	1.0832	1.0929	1.0867	1.0730	1.1140	1.0931
GBP	1.2399	1.2260	1.2447	1.2397	1.2270	1.2610	1.2425
JPY	129.50	129.01	131.11	129.85	127.20	131.00	128.33
CHF	0.9197	0.9156	0.9279	0.9206	0.9080	0.9330	0.9127