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Weekly Money Market Report
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Markets Calmed on Signs of Abating Inflation

Highlights

- **Investors took some comfort from the US Federal Reserve's meeting minutes that did not show a more aggressive path in response to elevated inflation, however added half-point rate hikes are appropriate moving forward.**
- **Providing signs of cooling inflation, Core PCE gained just 0.2% last month after shooting up 0.9% in March. Additionally, the Congressional Budget Office estimates US GDP will exceed 3% this year and that inflation will cool to around 2% by 2024.**
- **Business activity in Europe's largest economy remains strongly supported by strength in the country's services sector. Germany's flash services and manufacturing PMIs came in at 56.3 and 54.7 respectively.**
- **In the UK, Bank of England Governor Andrew Bailey defended the banks approach on a cautious approach to raising interest rates even as UK inflation hit 9% in April.**
- **The RBNZ raised interest rates by half a percentage point for a second straight meeting while hinting at further aggressive hikes to come.**
- **Last week, the dollar ended slightly lower though remains supported with the index last seen at 101.668.**

Global economies have experienced a sustained rise in inflation since the late 2020s following the outbreak of Covid-19. As the outbreak began to subside, price levels were further intensified by the Russian military operation in Ukraine in February. Russia is the world's second-largest producer of crude oil and a key exporter of gas and aluminum, while Ukraine is a key exporter of wheat, resulting in both energy and food price increases in Europe. Additionally, China is now two months into harsh Covid lockdowns that have choked global supply chains. Today, price uncertainty, supply constraints, and an unclear end to the Russia-Ukraine conflict will continue to threaten the post-pandemic recovery. On a positive note, last week's Federal Reserve minutes and the release of PCE helped dampen fears regarding high interest rates, with global stocks marking their first weekly gain after seven straight weeks of declines.

The greenback lost 1.32% of its value last week, leaving the euro and pound above the 1.07 and 1.26 marks respectively. Meanwhile safe havens such as the Japanese yen and Swiss franc saw stronger support against the USD, ending the week 0.63% and 1.78% higher respectively. On Wall Street, the S&P 500 recovered all losses incurred in the previous two weeks after ending the week 6% higher. Moving to bonds, yields on 2-year and 10-year Treasuries marked their third week of declines.

United States

Fed Minutes lack Surprise

Minutes from the US Federal Reserve's May 3-4 meeting echoed Fed Chairman Jerome Powell's urgency to tackle inflation as voiced in his post-meeting press conference. The May meeting resulted in the central bank raising interest rates by a half point to a range of 0.75%-1.0%, while unveiling plans to begin reducing the size of its $9 trillion balance sheet consisting mostly of Treasuries and mortgage backed securities.

While hinting at similar hikes in the future, they further noted that policy may have to move past a "neutral" stance in which it is neither supportive nor restrictive of growth. Inflation was mentioned 60 times in the minutes as members expressed concern, noting that the war in Ukraine and Covid associated lockdowns in China would exacerbate inflation.

Nevertheless, officials remained committed to raising rates and reducing the balance sheet. The minutes stated that doing so would leave the Fed "well positioned later this year" to reevaluate the effect policy was having on inflation. The Fed's minutes confirmed two more 50 bps hikes in June and July, with policymakers suggesting a potential pause later in the year. Markets cheered that the minutes did not take a more hawkish tone as inflation continues to run at a 40-year high.

Lowest PCE Increase in 18 Months

In an encouraging sign of abating inflation, the Federal Reserve's preferred measure of inflation rose just 0.2% in April, marking the smallest increase in a year and a half. Looking over the past year, PCE slowed to 6.3% in April from a 40-year high of 6.6% in March, demonstrating the first decline since November 2020. A narrower measure of inflation that omits volatile items such as food and energy rose a somewhat higher 0.3% in April. Nevertheless, even the increases in the core rate were the smallest since last summer. On a yearly basis, the core rate slowed to 4.9% from 5.2% - its second straight decline. The last time the core rate was seen declining back-to-back was in 2020, early pandemic.

Looking at GDP, US economic growth will exceed 3% in 2022 while strong inflation has peaked and will cool to around 2% by 2024, according to Congressional Budget Office estimates. The growth will be driven by consumer spending and demand for services. However, the upbeat report depends on the notion that the Federal Reserve will be able to raise interest rates throughout 2022 and 2023 without tipping the US economy into a recession. "In CBO's projections, the current economic expansion continues, and economic output grows rapidly over the next year," the CBO said in its report. "To fulfill the elevated demand for goods and services, businesses increase both investment and hiring, although supply disruptions hinder that growth in 2022."

Europe & UK

German Economy Supported by Strength in Services

Business activity in Europe's largest economy continued to grow, led by a strong post-lockdown recovery particularly across the country's service sector. Nonetheless, there are signs of weaning demand due to market uncertainty, rising prices and supply issues evident by manufacturers reporting the steepest drop in new orders for almost two years. The headline PMI Composite Index came in at 54.6 in May, recording a slight improvement from April's 54.3 amid a sustained strong rebound in the service sector's business activity. Breaking it down, the flash PMI index for services was 56.3 in May, down from April's 57.6 level though still well above the 50-expansion mark. Meanwhile the flash PMI for manufacturing improved slightly this month to 54.7 from April's final reading of 54.6.

Bailey Defends BoE's Cautious Approach

Last week, Governor Andrew Bailey sought to defend the Bank of England's cautious approach regarding monetary policy, noting policymakers are considering the wider picture of the inflation shock facing the economy. While the central bank concluded its fourth rate rise in a row, many are still questioning whether it should be acting more aggressively with larger hikes. Notably, the bank's Monetary Policy Committee approved the hike however faced three dissenters after UK inflation hit 9% in April, a figure expected to remain exacerbated by the war in Ukraine.

Bailey admitted he the BoE could not claim to have any "tremendous foresight" in the current situation, however added that regarding raising rates he was "prepared to do so again based on the assessment at each of our meetings". He did however warn that the BoE was still assessing how far inflation might fall on its own. "We are facing a very big negative impact on real incomes caused by the rise in prices of things we import, notably energy. We expect that to weigh heavily on demand," Bailey said, adding that this made him hold back when making any public commitments regarding the likely path of interest rates. "We have to be careful and we have to take these decisions meeting by meeting, which is why I don't want to overuse forward guidance," he said, noting that the central bank faced the combined risks of "high inflation on one side and the risk of a recession on the other".

Asia-Pacific

RBNZ Hikes for Second Straight Meeting

New Zealand's central bank raised interest rates by half a percentage point for a second straight meeting while forecasting further aggressive hikes to come. The Official Cash Rate was lifted to 2% from 1.5% as widely expected. Moving ahead, the RBNZ projected the OCR to rise to at least 3.25% this year and peak to 4% next year. "It remains appropriate to continue to tighten monetary conditions at pace to maintain price stability and support maximum sustainable employment," the RBNZ said. "The Committee is resolute in its commitment to ensure consumer price inflation returns to within the 1-3% target."

The move marks the first time the central bank delivered consecutive 50 basis-point increases since the OCR was introduced in 1999. Stable inflation expectations "will be a key indicator that the current monetary policy strategy is working," it added. Today, the RBNZ projects inflation will slow to 3% in the second half of 2023 from a peak of 7% in the current quarter, and prices are not seen returning to the 2% midpoint of the target band until 2025.

Commodities

Oil Supported amid Supply Concerns

After gaining nearly 50% YTD, oil prices remain supported by the prospect of a tight market due to rising consumption in the US over the summer and the possibility of an EU ban on Russian oil. US gasoline stocks fell by 482,000 barrels last week to 219.7 million barrels just before the start of summer season in the US, which normally entails increased consumption. Additionally, prices also found support by the European Commission's continuous attempt to seek unanimous support of all 27 EU member states for its proposed new sanctions against Russia. OPEC+ are expected to stick to last year's oil production deal at its June 2 meeting and raise July output targets by 432,000 barrels per day despite Western calls for faster increases. The price for brent crude gained 6% last week and ended at a 7-week high of $119.43.

Kuwait

Kuwaiti Dinar

USD/KWD closed last week at 0.30575.

Rates – 29TH May, 2022

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.0570	1.0556	1.0764	1.0727	1.0530	1.0840	1.0785
GBP	1.2476	1.2469	1.2666	1.2616	1.2420	1.2725	1.2628
JPY	127.92	126.35	128.08	127.11	126.20	129.10	126.57
CHF	0.9743	0.9543	0.9751	0.9570	0.9460	0.9765	0.9520