Weekly Money Market Report
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Inflation Woes

Highlights

- **US CPI rose last month at its fastest pace since August 2008.**
- **The Fed held its ground on its view that the inflation increases would be transitory and will eventually subside.**
- **The Fed would continue discussions later this month on reducing its $120bn in monthly asset purchases.**
- **Britain's inflation rate rose to 2.5% in June, far exceeding expectations.**
- **The pace of recovery in the worlds' second largest economy rose modestly in the second quarter of 2021.**

United States

The Fed Maintains Its Stance Amid Rising Inflation

Consumer price index, a key measure of inflation for the Federal Reserve was released on Tuesday where it showed the pace of US consumer prices has accelerated unexpectedly in June.

The reading showed CPI rose last month at its fastest pace since August 2008, surging 5.4% from the previous year, while surpassing the 5% increase reported in May and the 4.9% rise forecasted by economists. On a monthly basis, the data showed price gains of 0.9%, the biggest one month jump since June 2008. Core CPI, the figure that strips out volatile items such as food and energy, rose from a yearly increase of 3.8% in May to 4.5% in June.

The inflation figure had investors, economists and policy makers scrutinizing the reading in the middle of a debate about the risk of runaway consumer prices, fueled by ultra-accommodative fiscal and monetary policy.

Looking at the numbers it is apparent that price jumps have so far been most significant in sectors directly affected by the coronavirus pandemic. The highest driver being prices of used cars which have soared due to a semiconductor shortage, semiconductors are an essential component in building new cars, and the shortage made new cars scarce, driving the soaring demand to the limited used car market. Fed Chair Jerome Powell has repeatedly invoked used car prices as evidence for the temporary nature of the current inflation surge.

Other factors having a hand in the rising figures included travel related expenses such as airfare, hotel prices and car rental costs, all rising due to lockdowns being loosened. Energy prices also surged as Americans shook off pandemic restrictions and took to the roads again.

Fed officials had predicted in June that their preferred gauge of core inflation would rise by 3% this year before mellowing down to 2.1% in 2022. But Tuesday's reading saw economists believing that the surprisingly high inflation could pressure the regulator to consider slowing monetary stimulus by reducing asset purchases sooner than previously though.

The Biden administration has previously expressed confidence that the surge in prices would subside, and continued to defend that view after the data were published. The White House's Council of Economic Advisers on Tuesday stressed in a series of tweets that, outside of disruptions related to the pandemic and supply chain issues, core CPI had risen by 0.22% month over month, relative to 0.28% in May and 0.31% in April. "We're at a place where a set of pandemic related services are still normalizing their prices back to where they were before the pandemic. We're in a world where we see a very concentrated bottleneck around autos, and everything else in the core series we're seeing deceleration," a White House official said on Tuesday.

A day following the release of the US inflation date, Federal Reserve chair Jerome Powell testified in front of the Congress, where he fended questions from Republicans and Democrats alike, in a bid to ease concerns over the Fed's response to surging inflation.

Powell pushed back against suggestions that the regulator might be complacent about inflation risks, saying that the Fed was ready to act if needed to tame prices and that he sympathized with public concern over rising prices. "I know people are very worried about inflation, we hear that loud and clear from everybody, it is really going through the economy and through every business," said Powell.

Powell largely stuck to his view that the inflation increases would be transitory and will eventually subside. Powell did not break any new ground on monetary policy during the three hour hearing, he reiterated that the central bank would continue discussions later this month on reducing its $120bn in monthly asset purchases, and that the Fed is not yet debating a rise in its main interest rate from its rock bottom level.

Powell sought to strike a balance between accepting that the inflation readings had caught the fed off-guard so far, while also stressing that the big picture had not changed. He said "It is still the same story. It is still the same parts of the economy that are producing this inflation. It is a pretty narrow group of things that are producing these high readings, but we are anxious like everybody else to see that inflation pass through." He also urged lawmakers to have "faith" in the Fed's judgment that it was still riskier to tighten policy too early than too late. "We really do believe and virtually all forecasters do believe that these things will come down of their own accord as the economy reopens — it would be a mistake to act prematurely."

Additionally, Powel said that in six months' time, the regulator would have a much firmer grip on both inflation and labor market data, helping it make any further policy decisions.

UK

Rising Inflation Worries The BoE

Figures released on Wednesday showed Britain's inflation rate rose to 2.5% in June, far exceeding expectations and adding pressure on the Bank of England to take the increase in prices more seriously. Economists had expected the rate of inflation to tick up from 2.1% in May to 2.2%. The figure is alarming considering that it came up from an annual rate of only 0.4% in February.

The Office for National Statistics (ONS) said that the rise in prices was widespread in June, challenging the BoE's view that any increase in inflation above its 2% target would be transitory. The third consecutive month of higher than expected inflation indicated that businesses have responded to the relaxation of coronavirus restrictions with an effort to build their profit margins.

The pattern of the UK's much faster than anticipated rise in inflation is similar to the patterns seen in the US. Second hand car prices were signaled out by the ONS as the driver of inflation this year, alongside with price increases for food. The ONS also said that some of the price rises had temporary elements, such as the increase in costs of fuel linked to higher oil prices and some prices rising after temporary cuts during the pandemic.

The rapid rise in prices in the second quarter suggests that the peak will be considerably higher than the BoE's predicted peak of about 3% later in 2021. Inflation is likely to surge sharply again in the fall season on the back of higher gas and electricity prices, in addition to higher restaurant prices when the temporarily reduced value added tax rate on hospitality is removed bringing back VAT's to their pre pandemic levels.

A senior BoE official commented on the figure saying that the sharp uptick in prices showed that the regulator had underestimated the strength of the rebound in prices, and that monetary policy might have to be tightened earlier than previously thought. Sir David Ramsden, deputy governor for banking and markets at the BoE, spoke on Wednesday evening saying "Based on the rapid pace of developments since we published our May forecasts and the shift in the balance of risks I can envisage those conditions for considering tightening being met somewhat sooner than I had previously expected."

The BoE does not give guidance on when it will start to tighten policy but, ahead of the June inflation figures; financial markets did not expect any rise in interest rates before 2023. Derivative markets linked to the path of BoE rates are now fully pricing in an increase to 0.25% by November 2022, where prior to Wednesday's inflation data, such tightening in monetary policy had not been expected until May 2023.

Asia

Moderate Recovery

Data released in China showed the pace of recovery in the worlds' second largest economy rose modestly in the second quarter after signs of sluggishness invoked expectations of greater policy support. On quarterly basis, China's GDP grew 1.3% in the three months leading to June, up from a revised 0.4% expansion in the previous quarter. Second quarter GDP was 7.9 per cent higher than a year earlier, compared with year-on-year growth of 18.3 per cent in the first quarter.

Signs of downward pressure on China's recovery have prompted speculation that Beijing will unleash more policy support to shore up business confidence and employment and lift spending.

Kuwait

Kuwaiti Dinar

USD/KWD closed last week at 0.30055

Rates – 18 July, 2021

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.1870	1.1770	1.1879	1.1805	1.1750	1.1900	1.1827
GBP	1.3900	1.3758	1.3910	1.3772	1.3700	1.3900	1.3775
JPY	110.15	109.70	110.69	110.08	109.00	111.40	110.00
CHF	0.9145	0.9116	0.9203	0.9194	0.9125	0.9275	0.9172