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Weekly Money Market Report
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>NBK Treasury
+965 22216603
tsd_list@nbk.com

Jobs Data Suggest the Fed will Keep Rates Higher for Longer

Highlights

- **Major central banks raised interest rates in line with expectations, volatility prevailed afterwards.**
- **The euro zone managed to grow in the final three months of 2022, avoiding a recession even as high energy costs, diminishing confidence and rising interest rates weighed on the economy that is likely to persist into this year.**
- **China's economy showed a sharp recovery in January after lifting restrictions on its zero COVID policies.**
- **The dollar managed to close the week higher as labor market data on Friday showed that employers added significantly more jobs than the anticipated potentially giving the Fed more space to keep rates higher for longer.**

Volatility Prevails amid Major Central Bank Meetings

Last week central bank meetings took center stage and delivered their widely expected rate hike decisions. The Federal Reserve (Fed) further reduced the magnitude of its hike to 25 bps and acknowledged the recent disinflationary pressures, while reiterating that further hikes are on the table to continue the fight against inflation. Similarly, the European Central Bank (ECB) and the Bank of England (BoE) hiked by 50 bps in line with expectations. Yet volatility dominated the FX scene as market participants interpreted the forward guidance as an indication that we might be reaching the peak of the hike cycle in March.

Driving the call for a pause in hikes and potentially a pivot by the Fed are signs of receding inflationary pressures combined with contractionary signs in the US economy. Meanwhile, Fed policymakers through last year kept escalating their own estimates for how high they would push interest rates as inflation proved stronger and stickier than anticipated. Not once did they hint rates would be lowered this year. How the current disconnect develops will largely come down to whether inflation retreats faster than the central bank expects, or labor markets soften further than it hopes.

Also noteworthy is the improvement in market sentiment stemming from the IMF's upwardly revised global growth outlook citing the positive impact from the recovery of China's economy after the lifting of its zero COVID policy and signs of easing inflation. The fund sees global GDP expanding 2.9% this year, 0.2% more than forecast in October.

The dollar index initially gained after the Feds meeting on Wednesday only to retest a 9-month low as the dovish sentiment took over. Similarly equites took a dive after the announcement only to reverse upwards and close higher on the day. Following the ECB and BoE meetings the euro & pound traded in a volatile manner only to settle lower as markets priced in a slower pace of hikes going forward – ECB and BoE probabilities of a 50 bps hike stood lower than 65% on Friday.

The Dollar managed to close the week higher as labor market data on Friday showed that employers added significantly more jobs than the market anticipated potentially giving the Fed more space to keep hiking rates. Probabilities of the Fed raising by 25 bps in March rose from 80% to 95% after the release. The pound and the euro closed the week lower against the greenback at 1.2051 and 1.0793 respectively. Against the yen the dollar skyrocketed from the lows of 128.20 to close at 131.20 as the announcement indicates a potential widening in interest rate differentials in favor of the dollar. Equities slid and bond yields surged after the release.

United States

Fed Raises Rates at a Slower Pace

Federal Reserve Chair Jerome Powell spoke after the decision to raise interest rates by 25 bps to a range of 4.5 - 4.75%. Jerome Powell said that he sees for the first time that “the disinflationary process has started.” However, he did stress that it was “premature to declare victory” on inflation and lamented on the tight labor market with unemployment near 50 year lows. Powell signaled that they are thinking about “a couple more rate hikes” to get to an appropriately restrictive level. Despite this, he also signaled that the Fed are giving themselves flexibility for future monetary policy moves, saying that it is “certainly possible” terminal rates remain under 5% but that its dependent on data. Powell’s base case remains that there will be growth this year, though at a “subdued pace.”

Job Report

US job growth rose significantly higher than expected in January indicating signs of persistent resilience in the labor market. The closely watched jobs report showed that nonfarm payrolls rose by 517,000 last month versus expectations of 185,000. Data for December was revised higher to show 260,000 jobs added instead of the previously reported 223,000. Meanwhile, average hourly earnings rose 0.3% after gaining 0.4% in December. That lowered the year-on-year increase in wages to 4.4% from 4.8% in December, while economists expected wages to increase by 4.3% year-on-year. The unemployment rate stood at 3.4% versus 3.5% in December.

Consumer Sentiment

US consumer confidence unexpectedly fell in January as households continued to worry about the economy's prospects over the next six months. The Conference Board said its consumer confidence index slipped to 107.1 this month from 109.0 in December. Economists had forecast the index at 109.0. The survey places more emphasis on the labor market, which remains tight.

Consumers' 12-month inflation expectations rose to 6.8% from 6.6% last month. The present situation index, based on consumers' assessment of current business and labor market conditions, increased to 150.9 from 147.4 last month. But the expectations index, based on consumers' short-term outlook for income, business, and labor market conditions, dropped to 77.8 from 83.4 in December. This measure is below 80, a level The Conference Board says was associated with recession.

Europe

The European Central Bank Hiked by 50 bps as Expected

The European Central Bank (ECB) raised interest rates by 0.5% last week and signaled at least one more hike of the same scale next month, reiterating it would stay the course to curb high inflation. However, financial markets immediately interpreted the move as suggesting the tightening cycle might in fact end soon. The ECB has been increasing rates at a record pace to fight inflation which is the result of factors including the aftermath of the COVID-19 pandemic and an energy crisis that followed Russia's invasion of Ukraine almost a year ago.

"The Governing Council intends to raise interest rates by another 50 basis points at its next monetary policy meeting in March and it will then evaluate the subsequent path of its monetary policy," the ECB said. The statement raised expectations that a possible pause or a slowdown in the pace of hikes would take place beyond March.

ECB President Christine Lagarde disputed the interpretation that Thursday's move meant the hiking cycle was near the end. “No. We know that we have ground to cover, we know that we are not done," Lagarde told a news conference, reiterating the bank's mantra that it would "stay the course" in the fight to bring inflation back down to its target of around 2%.

The disconnect between the ECB message and the market interpretation mirrored the reaction after the Fed slowed the pace of hikes a day earlier and acknowledged disinflation was underway, while reaffirming that borrowing costs needed to rise further.

Eurozone Inflation

Inflation in the Eurozone slowed by more than expected in January, although the figures only include an estimate of price growth in the bloc's biggest economy Germany.

The Eurozone consumer price index dropped by 0.4% month-on-month during the period, matching the decrease seen in December versus expectations of a decline of 0.3%. On an annual basis, the rate of inflation decelerated to 8.5%, down from 9.2% in the prior month and below economists' predictions of 9.0%. The reading peaked at a euro-era high of 10.6% in October.

Supporting this decline was a 0.9% dip in monthly energy price growth, as many European countries are experiencing a milder winter than had been initially anticipated. Energy prices in the Eurozone are still elevated annually, rising by 17.2%. Meanwhile, yearly core inflation, which strips volatile items like food and energy, remained unchanged at 5.2%. Economists had predicted that the number would accelerate to 5.4%.

Eurozone GDP

The euro zone managed to grow in the final three months of 2022, avoiding a recession even as high energy costs, diminishing confidence and rising interest rates weighed on the economy that is likely to persist into this year. Gross domestic product across the currency bloc expanded by a tiny 0.1% in the fourth quarter, outperforming expectations for a 0.1% drop. Compared to a year earlier, growth was 1.9%.

Among the biggest euro zone countries, Germany and Italy recorded negative growth rates for the quarter but France and Spain expanded. Russia's war in Ukraine has proved costly for the euro zone, given some members' heavy reliance on cheap energy.

Surging oil and gas prices have depleted savings and held back investment, while forcing the European Central Bank into unprecedented rate hikes to arrest inflation. But the economy has displayed some unexpected resilience too, much like during the COVID-19 pandemic, when growth outperformed expectations as businesses adjusted faster to changed circumstances than policymakers had predicted.

More recent figures like a crucial confidence indicator or the latest PMI data suggest growth may have hit bottom already and a slow recovery is underway, helped by generous government support and a mild winter that has limited energy spending.

Nevertheless, the overall picture remains fragile, with weak growth forecast for 2023 due to a large drop in real incomes and surging interest rates.

United Kingdom

The Bank of England Raises Rates and Signals Slowdown in Hike Path

The Bank of England (BoE) raised interest rates for the 10th time in a row last week but dropped its pledge to keep increasing them "forcefully" if needed and said inflation had probably peaked. Softening their forecasts of a recession this year, the BoE's nine interest rate-setters voted 7-2 to increase their key lending rate to 4.0%, its highest since 2008, from 3.5%. The move had been expected by most investors and economists.

The BoE, which is trying to oppress the risks from Britain's 10% inflation rate without deepening the expected recession, said its run of rate hikes going back to December 2021 was likely to have an increasing impact on the economy. That should help to bring inflation down to about 4% by the end of this year, it said. Previously the BoE had forecast 2023 inflation at around 5%. "Since the November monetary policy report we've seen the first signs that inflation has turned the corner," Governor Andrew Bailey said in a conference following the rate hike. "But it's too soon to declare victory just yet, inflationary pressures are still there."

The UK central bank's Monetary Policy Committee (MPC) said further interest rate hikes would hinge on evidence of more persistent price pressures appearing. That represented a signal to investors that its fast run of rate hikes might be coming to an end. Previously the BoE had said it would "respond forcefully, as necessary" to signs of further inflation pressure, and that "further increases in Bank Rate may be required".

The BoE expects inflation to fall below its 2% target in the second quarter of 2024, but it warned there were upside risks to this forecast from persistent labor market pressures and higher-than-expected core and domestically generated inflation.

The IMF Expects UK's Economy to Deflate in 2023

Britain faces the severest two years of any major industrial nation, with a recession in 2023 and the slowest growth of peers in 2024, according to the International Monetary Fund. Moreover, the IMF expect the UK's economy to deflate by 0.6% this year, the only contraction in the G7, as higher interest rates and taxes along with limited government spending intensify the cost-of-living crisis.

China

Chinese Manufacturing Signals Expansion Amid Lifting Restrictions

China's economy showed a sharp recovery in January after lifting restrictions on its zero COVID policies. The manufacturing PMI rose to 50.1 compared to December's 47.0 print. Furthermore, the non-manufacturing PMI that includes necessities like services and construction increased to 54.4 from 41.6 just last month. Numbers above 50 represent an expansion, while anything below indicates contraction. The surprise on the upside and recovery is faster than economists expected, given the waves of COVID infections and the celebration of the lunar new year which tends to lead to slower economic activity. Additionally, the International Monetary Fund raised its global economic growth outlook to 2.9%, the first increase in a year, while expecting China's economy to grow to 5.2% in 2023.

Kuwait

Kuwaiti Dinar

USD/KWD closed last week at 0.30465.

Rates – 05th February, 2023

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.0866	1.0790	1.1033	1.0793	1.0600	1.0900	1.0850
GBP	1.2390	1.2045	1.2417	1.2051	1.1900	1.2300	1.2073
JPY	129.81	128.07	131.21	131.17	129.00	133.00	129.52
CHF	0.9207	0.9058	0.9288	0.9257	0.9100	0.9500	0.9170

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