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

Recession Worries Ring as Global Troubles Translate into Local Repercussions

Highlights

- **The American economy moderates, European inflation soars, the Chinese economy picks up speed, while the Japanese economy struggles to rise.**
- **Risk sentiment remains fragile, markets close with milestone losses as rate hikes and worries drain liquidity and spark losses in a wide range of assets.**
- **The steady and aggressive global switch to tighter policy has stoked recession worries, shaken financial markets, and sent a significant flow of demand to dollar, sending the US Dollar index to 105.12.**

United States

Economy Moderates, Demand Cools

The US economy maintained its strength but has shown signs of losing steam. Business investment remains firm even in the face of rising interest rates and mounting concerns about the economy. Orders placed with US factories for durable goods rose more than expected in May. Bookings for durable goods, items meant to last at least three years, increased 0.7% in May after a 0.4% advance a month earlier and core capital goods orders, a proxy for investment in equipment (excludes aircraft and military hardware), also rose 0.7% after a 0.3% gain a month earlier. However, a measure of consumer confidence dropped more than expected in June, and a measure of expectations, which reflects Americans' six-month outlook, fell to its lowest in nearly a decade.

There are signs that underlying price pressures are beginning to abate. Q1 GDP was revised sharply lower to a 1.6% decline from a 1.5% decline, marking a surprise sharp downward revision that suggests an economy on weaker footing than previously thought. Spending on both services and merchandise was revised lower. Within services, outlays for financial services, insurance and health care were marked down. Spending on goods was revised to an annualized 0.3% decline, reflecting less robust spending on durables. Outlays for non-durable goods shrank at a 3.7% rate. The Fed's favored measure for inflation target, Core PCE, rose by 0.3%, the same rate as the previous month, and 4.7% year-on-year, as higher prices forced cutbacks on purchases of goods, another sign that rebound in economic growth is losing steam.

The Fed Stands Strong

In the backdrop of the debate between executing a soft landing and tipping the economy into a recession, Fed officials continue to echo their endorsements in their ability to cool inflation without stepping too hard on the breaks that will slow the economy. Despite signs of fading, price pressures remained strong enough to keep the Fed on its aggressive monetary policy tightening path with hikes in the range of 50bps to 75bps on the table.

Fed Chair Jerome Powell reiterated his confidence that despite the task becoming increasingly difficult, the US economy is in strong shape and the Fed can avert a recession. He clarified that they would "not allow a transition from a low inflation environment to a high inflation environment" but that he "hoped" that growth would remain positive, again saying that the US economy was strong enough to withstand tighter monetary policy. He also mentioned the Fed's focus is on bringing down inflation, not the yield curve, and that market pricing for interest rate hikes fall roughly in line with the Fed's expectations.

Recession Fears Shelter the Dollar

Easing inflation expectations in the US and reassuring comments from the Fed failed to pour water on the wildfire of recession worries. Weaker US consumer confidence also came to dent sentiment. The data provoked worries that the Fed will have to be more aggressive in their rate hikes in order to tame inflation. Stocks posted dubious mid-year milestones – the S&P 500 posted its worst performance since 1970, closing down 20.6%. The Nasdaq 100 posted its worst performance on record, closing down 29.5%. The Dow Jones Industrial Average posted its worst performance since 1962, closing down 15.3%. Treasury yields also plunged below 3% on recession jitters.

The dollar kept firm as recession worries prevented peers from garnering any support for their currencies. The dollar gathered more momentum on the Fed's hawkishness and rising demand for liquidity as times become difficult in the uncertain in the monetary backdrop. The dollar index was well supported above 105, closing the week at 105.12.

Europe

Inflation Unrest

Euro-area inflation data gave mixed signals earlier, with German numbers coming in lower than expected while Spain's headline print unexpectedly rose to double figures. German inflation unexpectedly eased as temporary government relief measures reduced pressure on households and businesses that have been squeezed by a record surge in prices. Lower fuel taxes and discounted public-transport costs helped slow consumer-price growth to 8.2% in June from 8.7% in May. Inflation pressure remains intense elsewhere in the 19-member euro zone: Spain earlier reported a surprise jump to an all-time high of 10.2% in June from 8.7% in May, defying politicians' efforts to curb it.

While providing some respite for Germany itself, the reading is not expected to sway the European Central Bank (ECB) from lifting interest rates for the first time in more than a decade this month. With the measures implemented in Berlin being temporary in nature, German inflation may yet resume its advance, making any significant retreat of headline inflation highly unlikely for 2022. In addition, the growing threat of a Russian energy cutoff is stoking fears of a recession in Germany, the bloc's biggest economy, the kind of concern sweeping through Europe's largest economy. After President Vladimir Putin slashed flows on the main link to Europe, the outlook is already grim. Manufacturing orders at factories have fallen for the past three months, costs are rising, and confidence is crumbling. The Ifo Institute's closely watched measure of business expectations unexpectedly dropped this month.

ECB Talks Tough

ECB officials are united behind the plan to kick off a series of rate hikes starting this month despite being handed conflicting signals on the inflation they are trying to curb. The increase in Spanish inflation suggests that Eurozone inflation is moving up and not down like German inflation. To some extent, today's German inflation data also sends the message that government intervention have helped bring down inflation. ECB President Christine Lagarde affirmed plans for an initial 25bps increase in July but said policy makers are ready to step up action up to 50bps tackle record inflation if warranted.

The euro dropped below 1.0400 after mixed regional inflation data and dismal US data triggered a flight to safety and boosted the dollar. The euro closed the week at 1.0430.

United Kingdom

Forecast: Gloomy Skies, Pessimistic Rain

The Bank of England (BoE) repeated warnings of a grimmer road ahead. Governor Andrew Bailey believes soaring inflation will hit Britain harder than any other major economy during the current energy crisis and that the economy would likely weaken earlier and be more intense than others as a result of the energy price shock that all European economies face. The governor said that in the latest inflation data he had seen a shift in the causes of high inflation from high prices of goods that were in short supply after Covid-19, towards goods and services affected by Russia's invasion of Ukraine. However, he noted that the BoE was ready to raise rates more aggressively, suggesting that a 50bps hike may be on the table in August. The BoE has so far raised rates five times since December 2021.

The dollar rally sent the sterling below 1.2000, but managed to regain itself as it closed the week at 1.2098.

Asia Pacific

Australia: Coping Well Down Under

Australian retailers enjoyed a fifth straight month of sales gains in May, suggesting cashed-up households coped well after the first of two interest rate hikes by the Reserve Bank of Australia (RBA). Sales advanced 0.9% in May, more than double what economists had predicted, to a fresh record A$34.2 billion ($23.6 billion). The jump adds weight to expectations that policymakers will continue on a path of rapid monetary tightening this year. The RBA raised borrowing costs by half a percentage point this month and has signaled further hikes to come.

After losing ground and slipping below 0.6800, the aussie closed the week at 0.6816.

China: Economic Development Tide is Slowly Rising

Economic activity picked up in June after financial hub Shanghai lifted its lockdown, allowing businesses to restart and most residents to leave their homes. A rebound in small business confidence came from a survey of more than 500 smaller firms which showed that "demand and production recovered strongly among manufacturing," but "the manufacturing recovery was more significant than services," after contracting for two months. The Caixin Manufacturing PMI improved to 51.7 from 48.1 last month.

However, the housing sector continued to be a drag on the economy. Property sales declined in the first three weeks of June in the top four cities in China, even though sales in Shanghai last week had mostly recovered to the level before the lockdown. An official index that tracks apartment and home sales has now declined for 11 straight months - a record since China created a private property market in the 1990s.

The car market is making a gradually recovery after the lockdowns. Based on sales in the first two weeks of June, more cars were sold than the same period in 2021. The recovery in the services industry will likely take longer than for goods. Consumers are still unwilling or unable to go out as much as before since China's strict "Covid-Zero" policy means they face being quarantined for weeks. The restrictions and factory closures of the past months have also curbed the incomes of many businesses and workers.

Japan: Paralyzed Economic Growth puts Monetary Policy in No Mood to Budge

Stimulating sustainable economic growth continues to be challenge in Japan. CPI in May was spot on expectations, unchanged from April. That keeps the headline rate at 2.5% and the core rate, which excludes fresh food, at 2.1%, slightly above the 2% target. However, the bulk of that 2.1% rise is attributable to energy prices. Without fresh food and energy, Japan's inflation remains at a lowly 0.8%. Japanese industrial output dived its deepest in two years by 7.2% in May, when expectations were for a dip of only 0.3%. Consumer confidence, an indicator of consumer spending, also ticked down to 32.1 from 34.1 the previous month, against the expected 34.6 score. Unemployment worsened, with the rate rising to 2.6% from 2.5%.

The weaker and stagnating growth indicated in the data underscored the need for continuous stimulus. The Bank of Japan (BoJ) says that Japanese inflation is not sustainable, which in turn means no change in policy. "The BoJ will persistently continue with the current strong monetary easing and firmly support economic activities," said Governor Kuroda, "We're aiming for a virtuous cycle in which prices rise moderately while corporate profits, employment and wages improve,".

The fallout of the BoJ's policy stance as other central banks raise interest rates continues to be increasingly disruptive to the yen, sending it to all-time lows. The yen weakened further after Governor Kuroda reiterated his commitment to sticking with monetary easing and his yield-curve control framework that keeps short-term interest rates below zero and caps yields on 10-year Japanese government debt. The yen closed the week at 135.19.

Commodities

Oil Prices Caught in the Wildfire

Oil prices fluctuated, as the market remains structurally tight in the midst of fears of a global economic slowdown under the wave of monetary tightening, a strengthening dollar, and tugging demand and supply forces. On the demand side, forecasts have been trimmed from the Chinese economy being negatively affected by Covid lockdowns, recession risks, and the direct economic fallout from Russia-Ukraine conflict. On the supply side, OPEC+ continues to struggle in resupplying market at the rate it set in its production schedule and disruptions caused by civil strife. WTI and Brent closed the week at $108.43 and $111.63.

Kuwait

Kuwaiti Dinar

USD/KWD closed last week at 0.30675.

Rates – 3rd July, 2022

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.0483	1.0367	1.0488	1.0430	1.0245	1.0535	1.0499
GBP	1.2179	1.1977	1.2185	1.2098	1.1880	1.2190	1.2119
JPY	135.71	134.74	135.98	135.19	134.25	137.30	134.29
CHF	0.9551	0.9540	0.9641	0.9593	0.9380	0.9780	0.9528