PUBLIC

Weekly Money Market Report

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Inflation Dips, but Central Banks Fight On

Highlights

- **Economic activity in the US is losing momentum under the weight of interest rate hikes. Manufacturing activity, producer prices, and retail sales all posted declines.**
- **The Federal Reserve kept up the hawkish commentary nonetheless, indicating that there is still work to be done to tamper down on inflation.**
- **Investor sentiment in Germany improved sharply in January to the highest reading since February 2022, thanks to lowering energy prices and signs that inflation has peaked in the region.**
- **Inflation in the UK rose to 10.5% in December, down from 10.7% in November and a peak of 11% hit in October. Prime Minister Rishi Sunak has made halving inflation one of his five key pledges for the year.**
- **Overall decline in US economic data helped peers rise but hawkish Fedspeak defended the US dollar index in the 102 region.**

United States

Disappointing Set of Data

Economic activity in the US is losing momentum under the weight of interest rate hikes. New York manufacturing data for January fell to -32.9 in January from -11.2 in December, the lowest level since the early months of the pandemic, underscoring the pain facing producers. The survey of manufacturers in New York signaled a steep contraction in the manufacturing sector at the start of this year with new orders falling sharply on weak demand and slowing employment growth. The Philly Fed Manufacturing Index in January also declined to -8.9, but scored better than the forecasted -10.9 and last month's -13.8 figure.

On the production side, price pressures continued their ease in December. Last month, the producer price index (PPI) dropped by the most since the start of the pandemic. Headline PPI fell 0.5%, weaker than the 0.1% decline expected. On an annual basis, PPI rose 6.2%, down from 7.3% In November. The monthly decline was driven by a plunge in goods prices, notably energy and food. Excluding those components, core PPI rose 0.1% in December and 5.5% from a year earlier. Weakness in industrial output is gathering steam with business investment being held down by rising interest rates. Industrial production plunged in December, missing expectations by a margin and posting the third consecutive month of contraction. Total output fell by 0.7%, its biggest monthly decline since September 2021. The steep drop in industrial production and news of more job layoffs add to fears that US could already be in a recession.

On the consumer side, headline and core retail sales fell 1.1% in December, weaker than expected. Damage was widespread with 11 of the 14 main components posting monthly declines. The breadth of weakness underlines Americans' reluctance to spend amid the mounting toll of high inflation and squeezing incomes. Falling sales may force retailers and restaurants to cut or stabilize prices, which will help take a bite out of inflation and keep price growth slowing down.

Despite the slew of weaker than expected economic data, Federal Reserve officials made it clear their inflation fight is far from over. Policymakers began differing in their opinions on the path forward, with some backing a more moderate pace of rises and others backing a more aggressive path. FOMC members Lorie Logan and Patrick Harker said 25bp increments were more appropriate going forward, although both indicated that a terminal rate of over 5% was likely. James Bullard favors another 100bp of hikes this year, taking the Fed funds rate to 5.5%. Loretta Mester also expects rates to go above 5% even as inflation was moving in the right direction. John Williams, Susan Collins and Lael Brainard all indicated that rates had further to rise even as inflation slows. Williams noted that demand was still "very strong" relative to supply and that disinflation this year would be largely due to supply chains improving and commodity prices coming off last year's highs. Brainard said that rates may need to stay elevated "for some time" in order to get inflation sustainably back to the 2% target.

The US dollar index defended itself in the 102 range from support of hawkish Fedspeak and closed the week at 102.012.

Europe

Optimism Lingers in Europe

Investor sentiment in Germany improved sharply in January to the highest reading since February 2022. The German ZEW expectations index leaped by 40.2 points to 16.9 from -23.3 in December, well above forecast. For the first time since February 2022, the indicator is back in positive territory. There is increasing optimism that a Eurozone recession this year is likely to be shallow, with a warmer than usual winter so far and with inflation having probably peaked. The more favorable situation on the energy markets and the German government's energy price caps have contributed to this. In addition, export conditions for the German economy are improving from China's lifting of Covid-restrictions.

Sounds whistled that European Central Bank (ECB) policymakers are considering a slower pace of rate hikes from March. Minutes from the central bank's December meeting showed that "a large number" of policymakers had pushed for a 75bp hike, but compromised on 50bp with a more hawkish tone in the commentary. Raising interest rates by less than 75bps would send the wrong message and risk being perceived as inconsistent with the 2% inflation target, some argued. However, the steadiness of rate hikes and the time over which interest rates remained in restrictive territory mattered more. An increase of 50bps would allow the Governing Council to tighten monetary policy over a longer period.

The euro started the week off at 1.0836 and held itself at 1.0855, after hawkish ECB comments helped the currency maintain its position.

United Kingdom

Tempering Inflation Across the Atlantic

The UK's labor market remained tight in the three months to November, with the unemployment rate unchanged at 3.7% and average weekly earnings accelerating to 6.4% annually from 6.2% in the three months to October. Inflation dipped for a second month in December, boosting hopes that the worst cost-of-living crisis in a generation may be starting to ease. The Consumer Prices Index (CPI) rose to 10.5% in the 12 months to December 2022, down from 10.7% in November and a peak of 11% hit in October. Lower fuel prices along with clothing were behind the slowdown at the end of the year. However, core CPI remained steady at 6.3% annually, down only marginally from the 6.5% peak hit in September 2022.

With inflation still five times higher than the government's 2% target and a wave of strikes by public sector workers angry their wages are falling short of the pace of price increases, Prime Minister Rishi Sunak has made halving inflation one of his five key pledges for the year. Chancellor of the Exchequer Jeremy Hunt said he has more to do to bring down the cost of living. "High inflation is a nightmare for family budgets, destroys business investment and leads to strike action, so however tough, we need to stick to our plan to bring it down," Hunt said in a statement.

The Bank of England (BoE) has raised interest rates nine times in a row since December 2021. BoE Governor Andrew Bailey believes the UK has turned a corner on inflation, and that inflation will fall "quite rapidly" from late spring, largely due to lower energy prices. He also indicated that wage inflation, which has remained high in the latest data, might also start to cool in the coming months.

The sterling pound opened the week at 1.2218 and closed the week higher at 1.2393.

Asia-Pacific

China Still Bruised from Covid Zero

China's economy is facing a challenging recovery after years of stringent Covid restrictions, but the latest data showed signs the worst of the slump may be over. Retail sales data was much stronger than expected in December even though this strong growth came mainly from food and medicines. Retail sales fell only 1.8% annually. Items that experienced strong growth were medicines (39.8% annually), food (10.5% annually), beverages (5.5% annually), and automobiles (4.9% annually). Industrial production grew 1.3% annually, mainly due to gains in equipment manufacturing and chemicals related to the medicine manufacturing, which were in strong demand during the Covid wave. With local governments busy tackling Covid and dealing with uncompleted home issues, fixed asset investment grew only 1.5% annually in 2022.

China's economy is growing at the second slowest pace since the 1970s. Gross domestic product for full year 2022 grew by 3% only, far from the 5.5% goal set at the beginning of last year. Kang Yi, director of the National Bureau of Statistics (NBS), cast China's 3% growth as "relatively fast" in light of unexpected situations. However, "The foundation of (the) domestic economic recovery is not solid as the international situation is still complicated and severe while the domestic triple pressure of demand contraction, supply shock and weakening expectations is still looming," the NBS said in a release. The government is targeting 5% growth this year, and policy measures will aim to boost consumption and investment to achieve that goal.

The People's Bank of China (PBOC) kept the rate of its one-year medium-term lending facility (MLF) unchanged and added less cash than expected into the banking system before the Lunar New Year holidays. The extra liquidity injection on the 1Y MLF volume was CNY 79 billion (USD 11.6 billion) to reach CNY 779 billion (USD 114.8 billion) for January. The move indicates a cautious stance and is likely to fuel speculation the central bank may use other channels to ensure there is adequate liquidity.

Domestic Demand Slowdown in Japan

Japanese inflation accelerated to 4.0% annually in December from 3.8% in November, in line with forecasts. Core inflation, which excludes both food and energy, also rose to 3.0% in December from 2.8% in November. Core machinery orders fell further than expected in November, by 8.3% monthly and 3.7% annually, and the Tertiary Industry Index, which measures activity in the services sectors, fell 0.2% monthly in November on weaker retail trade. Annual PPI rose from 9.7% to 10.2% in December, higher than expected and the highest in 2022 than in any year on record. Higher costs for raw materials were a major factor, as well as price of electricity, gas, steel, and minerals.

However, Bank of Japan Governor Haruhiko Kuroda indicated that higher inflation is due to rising costs rather than stronger demand. Before the BoJ takes any normalization steps, higher wage growth must emerge to make inflation sustainable, he said. At their latest meeting last week, the Bank of Japan (BoJ) decided against making more adjustments to its yield curve control program, leaving its 10-year bond yields around 0% and its main policy settings unchanged, leaving its negative interest rate at -0.1%. The bank said it would continue large-scale bond buying and increase them on a flexible basis if needed in defense of its yield curve control program. Its updated forecasts indicate that the BoJ does not see inflation staying above 2% in a sustainable manner over the coming years.

Inflation Outlook	New	Previous
FY2022	3.0%	2.9%
FY2023	1.6%	1.6%
FY2024	1.8%	1.6%

The BoJ's move prompted a sharp slide in the yen. The currency fell over 2% after the news and failed to recover, closing the week at 129.57.

Kuwait

Kuwaiti Dinar

USD/KWD closed last week at 0.30525.

Rates – 22th January, 2022

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.0832	1.0764	1.0887	1.0855	1.0760	1.1050	1.0917
GBP	1.2214	1.2167	1.2435	1.2393	1.2290	1.2590	1.2417
JPY	127.83	127.21	131.57	129.57	127.50	130.60	127.97
CHF	0.9265	0.9083	0.9288	0.9204	0.9010	0.9290	0.9115