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Weekly Money Market Report
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Central Banks Harden Hawkish Tones

Highlights

- **The month of June is set to unfold with several central bank meetings, kicking off with the Reserve Bank of Australia (RBA) and the European Central Bank (ECB) this week.**
- **Inflation has yet to show more signs of letting up - In the US, momentum in the labor market and manufacturing sector indicated demand is still robust. Across the Atlantic, German inflation rang at 8.7% in May.**
- **The dollar strength was protected as uncertainty and concern mounts around global growth, elevated Treasury yields, and strong economic data weakens its peers.**
- **OPEC+ agrees to increase output by roughly 50% larger than what they agreed to increase in the last several months in a bid to meet depleting stockpiles.**

United States

Inflation Flame Blazes On

The latest ISM Manufacturing PMI stood in contrast to a handful of other regional Federal Reserve bank surveys (New York, Texas, Philadelphia, Richmond) that showed a clear pullback in factory activity in May from the previous month. The ISM Manufacturing PMI for May in the US was 56.1 vs the 54.5 expected and an April reading of 55.4 with strength seen in production, new orders, and inventory components. The ISM Services PMI for May was 55.9 vs the 56.5 expected and an April reading of 57.1. Although surveys showed price pressures eased slightly, supply chain issues and pricing were still the main issues that worried businesses. Another strong set of employment readings pointed to a tight labor market suggesting companies remain confident about demand and the economic prospect. Non-farm employment topped estimates adding 390K new jobs last month, and held the unemployment rate steady at 3.6%. Average hourly gains for May were also stable, growing by 0.3%.

Balance Sheet Reduction: Ready, Set, Deploy

The Fed's strategy to rein in inflation has garnered solid support from several Fed governors, including Christopher Waller, James Bullard, and Loretta Mester, who have reiterated the hawkish chorus of 50bp rate hikes in the coming meetings. Minutes from the Fed's meeting in May showed that officials are more open minded about what action to take in September, based on what happens with inflation. In addition, the $8.9 trillion balance sheet has officially begun with an amount of $15 billion in Treasury securities set to run off on June 15th. The process is expected to push rates higher. With signs that inflation is not letting up just yet, the road to the Fed's 2% target may be slow as a weakening and uncertain global growth outlook in the midst of soaring food and energy prices remain headwinds for progress.

US Treasury yields are back on the rise and stocks extended losses as a better-than-expected jobs report fanned fears that the pace of Federal Reserve tightening might pick up and become more restrictive. The 10-year yield stood at 2.93% and the 2-year yield at 2.65%.

Holler for the Dollar

The dollar remained resilient against its rivals armored by strong labor data, hawkish central bank calls, and elevated Treasury yields. The euro lost its grip after hitting a high of 1.0764 from its own hawkish central bank calls and inflation figures and found itself battered on the lower end of the 1.07 range, closing the week at 1.0722. The sterling succumbed to the pressure and was last seen trading at 1.2492 after almost reaching 1.2600. The Japanese yen, anguishing from the widening monetary policy divergence between the Bank of Japan (BoJ) and Fed, pummeled back to its lows at 130.86. The Australian dollar slipped to 0.7208 despite a stronger than expected GDP figure and anticipation ahead of the Reserve Bank of Australia (RBA) next week.

Europe

Inflation Aims for the Sky

Inflation in Germany, the region's largest economy, accelerated to 8.7% year-on-year in May, faster than market expectations and a sharp acceleration from the 7.8% recorded in April. High energy and food prices are driving prices higher as persistent supply chain issues along with the war in Ukraine exacerbate pressure on core inflation. Price pressures in all parts of the European Union (EU) economy are still rising. Spanish inflation accelerated to 8.5% in April from 8.3% a month earlier largely, on the back of higher energy costs and core inflation rose by 4.9% year-on-year.

As the inflationary shock takes hold in Europe, disruptions to Russian gas flows remain a key risk threatening shortages that could push countries like Germany into a recession. The impact of the Ukraine war and higher energy costs have led the European Commission to downgrade their forecast for 2022 growth to 2.7% from 4.0% previously.

ECB Gradualism Mantra Prevails

With inflation approaching four times the 2% target, the fear of persistent inflation and rising inflation expectations seem to have trumped worries of a recession with hawks emerging and making concerned calls for action. ECB President Christine Lagarde has signaled readiness to enact the first rate increase since 2011 in July following the conclusion of net asset purchases, but stressed subsequent moves won't be aggressive. Lagarde has pushed against assessments that the EU is suffering from the same kind of inflation pressures as the US even as high core prices appear to be entrenched.

Given that the surge in the region's inflation is spurred by bottlenecks in supply rather than being demand-led, the ECB will not be rushed into withdrawing stimulus, Lagarde said. Nevertheless, the hot inflation numbers across the Eurozone has raised the pressure to start normalizing rates from the July rate meeting, with a hike of as much as 50bps potentially in play.

China

Waking Up to an Economic Malaise

With the number of reported cases dwindling, China eased some of its strict lockdown curbs after two months of lockdown. Consequences of the "Covid Zero" approach have been grave to the economy and its outlook. The latest manufacturing data was sluggish but signaled a move towards more stable operating conditions across the sector as the pace of contraction slowed. Despite a rise in the Caixin Manufacturing PMI from 46.0, its 26-month low in April, to 48.1, it marked a third month of deterioration. The severity of supply chain delays, war worries, and slow post-pandemic recovery tanked business confidence to a 5-month low in May. Many economists expect the government won't meet its annual GDP growth target of about 5.5% this year.

Plenty of Action but No Traction

The People's Bank of China (PBOC) has been prompted to cut a key interest rate for long-term loans by a record amount by more than 15bps to 4.45% from 4.6%, the largest reduction since 2019, to boost demand. With Chinese banks overflowing with cash that no one wants to borrow, authorities face an uphill battle convincing companies and households to boost borrowing as long as Co-vid outbreaks and lockdowns continue to crush confidence.

In addition, China rolled out a broad package of measures to support businesses and stimulate demand as it seeks to offset the damage from lockdowns including additional tax rebates aimed at businesses worth C¥140 billion ($21 billion), representing about 0.1% of China's GDP last year. China also ordered state-owned policy banks to set up an 800 billion yuan ($120 billion) line of credit for infrastructure projects as it leans on construction to stimulate the economy.

Australia

Temperature Rising on the Australian Hike

The latest economic data from Down Under has been inviting for higher interest rates from the Reserve Bank of Australia (RBA). After a mammoth 3.6% quarterly growth in Q1 2021, Australian GDP slowed its pace, rising by 0.8% in Q1 this year and 3.3% annually. The slightly higher than forecast growth was bolstered by strong household spending.

The Reserve Bank of Australia (RBA) is likely to view this as validation for their hawkish pivot. As per the Minutes of the latest monetary policy meeting by the Reserve Bank of Australia (RBA), "Given the upside risks to inflation and the current extremely low level of interest rates, an argument for a 40 basis point increase could be made." Bets for an outsized 40bp interest rate hike are on the table for next week's meeting as it the RBA maintains its focus on inflation, at 5.1% in Q1 2022, which is running twice as fast as wage growth and tightness of the labor market that is near full employment.

Commodities

Still Hunting for Black Gold

In the latest spanner thrown in the works, oil prices ended the week higher in the wake of OPEC+'s announcement to increase production for July and August by 648K barrels a day for each month. It is roughly 50% larger than what they agreed to increase in the last several months, but too modest to appease tight markets. In the backdrop, a slow Chinese revival, a volatile demand outlook, the EU ban on Russian oil, and the dollar's muscle fight in influencing prices. WTI closed at $118.87 a barrel and Brent closed the week at $119.72.

Kuwait

Kuwaiti Dinar

USD/KWD closed last week at 0.30610.

Rates – 05th June, 2021

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.0749	1.0705	1.0766	1.0722	1.0530	1.0840	1.0773
GBP	1.2583	1.2486	1.2593	1.2492	1.2290	1.2580	1.2493
JPY	129.85	129.66	130.98	130.86	129.80	132.85	130.25
CHF	0.9581	0.9555	0.9642	0.9642	0.9540	0.9830	0.9569