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Weekly Money Market Report
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Rate Hike Extravaganza

Highlights

- **The Federal Reserve raised its benchmark interest rate by 0.75 of a percentage point in a move that equates to the most aggressive hike since 1994.**
- **European Central Bank will create a new tool to address fragmentation risk and temper bond rout.**
- **The Swiss National Bank raised its policy interest rate for the first time in 15 years.**
- **The Bank of England implemented a fifth consecutive hike to interest rates by 25 basis points to 1.25%.**
- **The Bank of Japan maintained ultra-low interest rates in its meeting.**

United States

All Aboard The Rate Hike Train

The Federal Reserve on Wednesday launched its biggest broadside bet against inflation, raising benchmark interest rates 0.75 of a percentage point in a move that equates to the most aggressive hike since 1994. At the end of its two-day policy meeting, the Federal Open Market Committee lifted its benchmark policy rate to a target range of 1.50-1.75%, noting that it "anticipates that ongoing increases in the target range will be appropriate".

Fed Chairman Jerome Powell spoke in his post-meeting news conference saying, "clearly, today's 75 basis point increase is an unusually large one, and I do not expect moves of this size to be common," He added, though, that he expects the July meeting to see an increase of 50 or 75 basis points. He said decisions will be made "meeting by meeting" and we, the Fed, will "continue to communicate our intentions as clearly as we can."
The decision marks an abrupt pivot from the Fed's previously laid plans for a second consecutive 0.50 percentage point rate rise, which had been signaled by policymakers before the start of a scheduled "blackout" period ahead of the meeting. Esther George, president of the Fed's Kansas City branch, was the sole dissenter and backed adhering to previous guidance.

FOMC members indicated a much stronger path of rate increases ahead to arrest inflation moving at its fastest pace going back to December 1981, according to one commonly cited measure, the "dot plot".

The Fed's benchmark rate will end the year at 3.4%, according to the "dot plot" of individual interest rate projections. That reflects an upward revision of 1.5 percentage points from the March estimate. The committee then sees the rate rising to 3.8% in 2023, a full percentage point higher than what was expected in March. Notably, the median forecast for the federal funds rate in 2024 was 3.4%, suggesting the Fed will need to reverse its rate rises in recognition of the fact that the economy is likely to have slowed considerably by that point.

The rate increase follows two reports released on the prior Friday that showed an unexpectedly large jump in consumer prices in May and a rise in inflation expectations, suggesting that Americans are becoming more concerned about the economic outlook.

"The committee is highly attentive to inflation risks," the Fed said in a statement, flagging that Russia's invasion of Ukraine has created "additional upward pressure" on inflation, weighing on economic activity. It added that extended lockdowns in China to combat Covid-19 surges had worsened supply chain disruptions that have increased prices.

Officials also significantly cut their outlook for 2022 economic growth, now anticipating just a 1.7% gain in GDP, down from 2.8% from March. The inflation projection as gauged by personal consumption expenditures also rose to 5.2% this year from 4.3%, though core inflation, which excludes rapidly rising food and energy costs, is indicated at 4.3%, up just 0.2 percentage points from the previous projection. Core PCE inflation ran at 4.9% in April, so the projections Wednesday anticipate an easing of price pressures in coming months.

The new economic projections published by the Fed indicate that the forthcoming monetary tightening — which also includes a scaling back of the $9tn balance sheet — will involve “some pain”, as Powell acknowledged last month. The Fed chair admitted that the path to bringing down inflation without causing significant economic damage was “not getting easier”. Powell added that the economic trajectory outlined in the new projections is reflective of a “softish” landing.

Europe

Emergency Meeting

The European Central Bank held an emergency monetary policy meeting on Wednesday, after bond yields surged in recent days for many governments across the Eurozone. During which it announced that it plans to create a new tool to tackle the risk of Eurozone fragmentation, in a move designed to moderate fears of a fresh debt crisis. “Since the gradual process of policy normalization was initiated in December 2021, the Governing Council has pledged to act against resurgent fragmentation risks,” the ECB said in a statement.

The decision to call an emergency meeting less than a week after the last governing council vote underlines how rate-setters are concerned that their aim to tackle record Eurozone inflation by ditching their crisis-era stimulus could be derailed if it revives bond market fears about the region’s weaker economies.

While there was no detail on how the ECB’s new instrument would work, some analysts think it could be an updated version of the securities markets programme that allowed the bank to tackle market fragmentation by buying €220bn of sovereign bonds from 2010 and 2012.

The Swiss Are Hiking

In a surprise move, the Swiss National Bank raised its policy interest rate for the first time in 15 years on Thursday, joining other central banks in tightening monetary policy to fight resurgent inflation. The central bank increased its policy rate to -0.25% from the -0.75% level it has deployed since 2015, the hike marks the first increase by the SNB since September 2007.

SNB Chairman Thomas Jordan said rising Swiss inflation - which hit its highest level in nearly 14 years in May - meant the central bank might have to act again. Even after Thursday's 50 basis point rate rise, the SNB expects inflation in the first quarter of 2025 to reach 2.1%, outside its target for a rate of 0-2%. In 2022 it expects a rate of 2.8%. "Without today's SNB policy rate increase, the inflation forecast would be significantly higher," Jordan told a news conference.

“The tighter monetary policy is aimed at preventing inflation from spreading more broadly to goods and services in Switzerland. It cannot be ruled out that further increases in the SNB policy rate will be necessary in the foreseeable future to stabilize inflation in the range consistent with price stability over the medium term,” it said in a statement.

United Kingdom

A Tamer Approach

The Bank of England on Thursday implemented a fifth consecutive hike to interest rates as it looks to rein in soaring inflation. The Monetary Policy Committee voted 6-3 to increase the Bank Rate by 25 basis points to 1.25%, with the three dissenting members voting for a 50 basis point hike to 1.5%. The BoE is moving more cautiously than other central banks while warning inflation would climb above 11% by the end of the year. Britain's benchmark rate is now at its highest since January 2009, when borrowing costs were slashed as the global financial crisis raged.

Minutes of the MPC’s meeting painted a dismal picture of the outlook for both growth and inflation. While the committee warned price pressures were becoming more embedded, the majority judged that the economy was already weakening enough to bring inflation under control without more drastic action. Some analysts were critical of the BoE's caution, saying it should have acted decisively to prove it would not tolerate double-digit inflation. But others said its approach reflected the UK's economic outlook, which is deteriorating faster than elsewhere.

Policymakers face the unenviable task of bringing consumer prices back under control against a backdrop of slowing growth and a rapidly depreciating currency, while the U.K. faces a major cost of living crisis. Inflation is surging worldwide due to spiking costs of food and energy, which have been exacerbated by the war in Ukraine and supply fears in agricultural commodities. Supply chain disruptions and demand shifts as a result of the pandemic have also driven up tradable goods prices. However, in its statement Thursday, the MPC acknowledged that not all of the excess inflationary pressure can be chalked up to global events, noting that domestic factors such as a tight labor market and the pricing strategies of firms have also played a role.

"Consumer services price inflation, which is more influenced by domestic costs than goods price inflation, has strengthened in recent months. In addition, core consumer goods price inflation is higher in the United Kingdom than in the euro area and in the United States," the Bank said. Although the BoE's staff now expects GDP to fall 0.3% in the second quarter of the year — a weaker outcome than projected in the bank's May forecasts — the committee saw little change in the growth outlook, with consumer spending and business sentiment holding up. It also saw no sign of pressures easing in the labor market, with businesses telling the BoE's agents that they expected to struggle with recruitment for at least the next 12 months. The three members that voted for the 50 basis point hike argued that faster tightening now would "reduce the risks of a more extended and costly tightening cycle later".

Asia-Pacific

Yet, Japan Holds Steady

The Bank of Japan maintained ultra-low interest rates on Friday and its guidance to keep borrowing costs at "present or lower" levels, signaling its resolve to focus on supporting the economy's tepid recovery from the Covid-19 pandemic. However, in a nod to the hit that the yen's recent sharp declines may have on the economy, central bank said it must "closely watch" the impact exchange-rate moves could have on the economy.

At the two-day policy meeting that ended on Friday, the BOJ maintained its -0.1% target for short-term rates and its pledge to guide the 10-year yield around 0% by an 8-1 vote. The decision was widely expected, yet it leaves the BOJ's stance even more at odds with other major central banks.

The growing monetary policy divergence between Japan and the rest of the world has pushed the yen to 24-year lows, threatening to cool consumption by boosting already rising import costs. The government and the BOJ have escalated their warnings against sharp yen falls, including by issuing a joint statement last week signaling readiness to step into the currency market if necessary. "We must carefully watch the impact financial and currency market moves could have on Japan's economy and prices," the BOJ said in a statement announcing Friday's policy decision.

Market Reaction

Volatile

The Japanese yen fell as much as 2% on Friday after the Bank of Japan jumped a wave of tightening and stuck with its ultra-low interest rate stance, as currency markets looked set for another volatile session after a flood of rate hikes this week. The SNB's surprise decision continued to reverberate through the markets, with the euro losing half a percent and the franc heading back towards two-month highs. The US dollar clawed its way back from a one-week low against major peers, following a two-day slide after the Federal Reserve's mid-week rate increase that, although the biggest since 1994, did not exceed market expectations. The sterling gained against the weakening dollar after it hit a low of 1.1988 to reach a high of 1.2406 then fell again on Friday in the face of the strengthening dollar. The euro also lost its earlier gains it gathered against the US dollar to close Friday's session down 0.46% at 1.0498.

In equity markets. Wall Street and beyond got the clear message from central bankers around the world, who said that they are going to try and strangle the inflation monster even if they risk crashing the economy along the way. Markets shed and bled but Friday saw a rebound for stocks in Europe and the US, snapping a two-day loss streak, signaling steadier sentiment.

Kuwait

Kuwaiti Dinar

USD/KWD closed last week at 0.30670.

Rates 19 June 2022

	Previous Week Levels				This Week's Expected Range		3-Month
Currencies	Open	Low	High	Close	Minimum	Maximum	Forward
EUR	1.0512	1.0357	1.0601	1.0498	1.0280	1.0600	1.0569
GBP	1.2323	1.1932	1.2406	1.2224	1.2030	1.2325	1.2246
JPY	134.37	131.48	135.58	134.96	133.95	136.60	134.12
CHF	0.9870	0.9617	1.0052	0.9697	0.9590	0.9890	0.9635