Weekly Market Summary

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Hawks Getting More Hawkish!
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As Netflix looked like it was having a Nokia moment this week, the mostly watched horror show, a.k.a. the "inflation mania", continued to haunt global markets with investors rotating from equities to commodities, real estate, and cash. U.S. Treasuries tumbled and equity-index futures extended losses as investors weighed major central banks willingness to embrace rate hikes in the tightening cycle.

It was another week, another series of hawkish comments from the Fed. Jay Powell sent his strongest signal so far that the Federal Reserve is prepared to raise rates by half a percentage point at its meeting next month as it ramps up efforts to stamp out soaring inflation. "It is appropriate in my view to be moving a little more quickly," the Fed chair said on Thursday at a panel hosted by the IMF. "We make these decisions at the meeting and we'll make them meeting by meeting, but I would say that 50 basis points will be on the table for . . . May." The view that the Fed should "front load" increases to its main policy rate so it quickly reaches a "neutral" level that does not stimulate growth was previously held only by the most hawkish officials, but it has become more widely accepted. The U.S. labor market has been strong, with employers adding nearly 1.7 million jobs in the first quarter, pushing the unemployment rate down to 3.6% last month. Fed officials forecast that slower growth abroad, tighter U.S. financial conditions, and less fiscal spending can slow U.S. demand and inflation without raising unemployment. Many economists think this is going to be a very close call on whether we get a recession or not. The Fed has to get monetary policy into tight territory, and they probably need to get some kind of rise in the unemployment rate. Powell also reinforced expectations for another half-point increase in June, by citing minutes from last month's policy meeting that said many officials had noted "one or more" 50 basis-point hikes could be appropriate to curb the hottest inflation in four decades. The policy sensitive two year yield climbed as much as six basis points to 2.74%, the highest since late 2018.

Federal Reserve Bank of Chicago President Charles Evans said that interest rates will probably rise above the level that neither restrains nor speeds up the economy -- but how much higher will hinge on whether inflation cools as expected. "Probably we are going beyond neutral. That's my expectation," Evans said. Federal Reserve Bank of St. Louis President James Bullard said the central bank needs to move quickly to raise interest rates to around 3.5% this year with multiple half-point hikes and that it shouldn't rule out rate increases of 75 basis points. "More than 50 basis points is not my base case at this point," Bullard said adding the Fed under Alan Greenspan did such a hike in 1994 leading to a decade-long expansion. In 1994, the Federal Open Market Committee (FOMC) wrestled with a similar dilemma as it considered emerging from a sustained period of low interest rates, amid signs of a reviving economy, growing aggregate demand, and no obvious signals of inflation. from January 1994 to January 1995, the FOMC raised the fed funds rate seven times, from 3 percent to 6 percent. At the time, a pre-emptive strike had never been done before. As then-Chairman Alan Greenspan put it in his 2007 memoir, The Age of Turbulence, such a strategy carried great risk. "Let's jump out of this sixty-story building and try to land on our feet," is how he described the feeling.

With the market now pricing in 3 distinct 50bps rate hikes in the next three FOMC meetings, all eyes have turned to the ECB whose stubborn refusal to move away from a negative interest rate policy, despite galloping inflation, has raised more than one eyebrow. Following a barrage of hawkish rhetoric from policymakers spurred speculation the bank is

priming the market for faster-than-expected monetary tightening, traders are now betting that the European Central Bank will raise rates above zero this year for the first time since 2012. Money markets are pricing in roughly 75 basis points of interest-rate hikes by the ECB's December decision, and also see an 80% chance of a quarter-point move in July. That's up from less than one quarter-point increase expected at the start of the year. With the ECB's deposit rate currently at a record low of minus 0.5%, that would push the bank's rate well into the green. Until last week, the debate at the Governing Council seemed to be focused on whether to hike the deposit rate in September or in December. Since the April meeting – which apparently killed the possibility of hiking in July – several members of the Governing Council have been calling to hike before September. Lagarde during the IMF panel discussion didn't give much away in terms of what the next policy steps could be for the ECB though. Asked about potential interest-rate increases, she pointed to the central bank's June meeting as the moment to take decisions based on new data, while also reiterating that the euro-zone economy is in a different place than the U.S. The euro touched $1.0758 Thursday, dropping like a stone after $1.08 barriers were breached, giving credence to the downside move that was no false break.

To make it look a little bit more painful, the Bank of England joined the rate-hike chorus. The governor of the Bank of England said he was concerned about the risks of persistent inflationary pressure from a strong labour market, even though he expects economic activity to slow over the rest of the year. Andrew Bailey said he feared that the economy might fall into recession if the central bank raised interest rates too far. Although the governor insisted that he was not sending precise signals about which way he would vote at a meeting of the Monetary Policy Committee in two weeks' time, his comments suggest that he thinks interest rates need to rise further. "We are walking this very, very fine line," the governor said, describing the twin pitfalls that threatened the UK economy. One was the potential failure of the BoE to "tackle inflation" and the other was "the risk that [the rising cost of living and higher interest rates] creates a recession and pushes too far down on inflation". Traders are betting on the BoE raising rates aggressively from 0.75 per cent to 2.5 per cent by this time next year. Catherine Mann, a former Citigroup economist who joined the BoE's nine-strong monetary policy committee (MPC) last year, said on Thursday that soaring prices of energy and food will persist next year, even if consumer demand weakens. Mann, who voted for a 0.5 point rate rise in February when the majority of the MPC voted for a smaller 0.25 point rise, said her "central concern" was "the domestic inflation ratchet" - a situation where price increases prompt more price increases in a vicious circle. The rate on two-year U.K. government bonds surged 13 basis points to 1.71%, the highest level since 2009. The pound hit the lowest level since November 2020 falling below $1.2900.

Last but not least, in zero-covid tolerance China, Q1 GDP figures came in stronger than expected, offset however by disappointing March data as the recent lockdowns weighed on outlook. China's gross domestic product rose 4.8% compared with the same period a year earlier, after expanding 4% in the final three months of 2021. On a quarter-on-quarter basis, GDP grew 1.3%, down from 1.6% in the first quarter. Analysts had projected gains of 4.2% year on year and 0.6% quarter on quarter as Covid outbreaks have increased, leading authorities to largely seal off the financial hub of Shanghai. A sharp deceleration in production and tumble in retail sales in March underline the initial damage from Covid-19 lockdowns in major cities including Shanghai. A slowdown in fixed asset investment suggests fiscal spending was not able to provide sufficient support in March for an economy constrained by strict virus countermeasures. April's data will probably reveal more weakness. What's more, exports which are a strong support for growth could slow as lockdowns to fight Covid-19 disrupt production, adding to downwards pressure from the impact of the Russia-Ukraine war.

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