

## The Week Ahead: Sticky price pressures raise interest rate hike probability

### ► US: Market expectations of rate hikes rising

The unexpected acceleration in April Core PCE (see below) and wider resilient economic data raise risks to our expectation for a prolonged pause in the Fed's interest rate cycle. We now see a strong possibility of a rate hike at the July meeting, though we cannot rule out a June increase. We believe the Fed would probably like to see more data before potentially returning to its rate-hiking cycle, especially after signalling a pause at the May FOMC meeting. The May NFP report (due Friday) will be a critical input to the Fed's 14 June policy decision, though a print in line with consensus expectations would allow the Fed to postpone any rate changes to the July meeting. Consensus expects non-farm job additions to slow to 190K in May (April: 253K), accompanied by an increase in the unemployment rate to 3.5% (3.4% previously) and a deceleration in wage growth to 0.3% m-o-m (April: 0.5%). Markets have reacted sharply to last week's developments, including debt ceiling agreements (page 2), with the probability of a 25 bps rate hike at the June meeting increasing from 18.0% to 66.7% over the last ten days. The minutes of the 2-3 May FOMC meeting released last week also showed the majority favouring the 'optionality' to hike, given persistent high inflation. Some participants expressed concern over the limited deceleration in services inflation and cited upside risks from ongoing tightness in labour markets. Fed staff projections also raised the core PCE inflation forecast for 2023 to 3.8% (from 3.6% in March), although they continue to see a mild recession later this year. Overall, we see the tone of the minutes to be on the hawkish side, with the subsequent acceleration in core inflation pressures likely to strengthen the position of the FOMC hawks.

### ► US: Acceleration in services inflation is a cause for concern

Headline PCE unexpectedly surged to 0.4% m-o-m in April (consensus: 0.3%; March: 0.1%), with higher energy prices and core PCE accelerating to 0.4% (March and consensus: 0.3%). In annual terms, headline PCE moved higher to 4.4% y-o-y (March: 4.2%), while core PCE rose to 4.7% y-o-y (March: 4.6%). The upside surprise in the core services (ex.-housing) segment led to a reversal in the core PCE decelerating trend that was seen over the last two months. Core services – the Fed's preferred gauge of price pressures – strengthened to 0.43% m-o-m (March: 0.28%), driven by a higher-than-anticipated rise in financial and insurance costs, other services and healthcare prices. The uptick in core services points to the challenges ahead in the Fed's disinflation fight, especially given the strong sensitivity to resilient wage growth trends. Housing PCE moderated to 0.5% m-o-m in April, slower than the previous 0.7%-0.8% range. Meanwhile, goods inflation remained steady at 0.2% m-o-m, as an increase in motor vehicle prices was offset by a sequential contraction in furniture and equipment and recreational goods prices. The University of Michigan survey showed inflation expectations moderating at both the 1Y (May: 4.2%; April: 4.5%) and longer-term (5-10Y) (May: 3.1% y-o-y; April: 3.2%) horizons, signalling some progress, though a lot more needs to be done to anchor inflation expectations towards the Fed's inflation target.

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Separately, US 1Q2023 GDP was revised higher to 1.3% q-o-q (1.1% first estimate) on stronger government spending and a more limited drag from inventories. In contrast, data also showed a contraction in gross domestic income (GDI) (1Q2023: -2.3% q-o-q; 4Q2022: -3.3%), indicating that the economy might have already entered a recession. We tend to lean more towards the growth in GDP figures, given the consistency with strong labour market data. Meanwhile, US President Joe Biden and House Speaker Kevin McCarthy agreed to an in-principle deal to suspend the debt ceiling until January 2025, removing uncertainty for financial markets. The deal involves caps on federal discretionary spending for the next two years, reducing the budget for internal revenue services and other spending clawbacks. McCarthy expressed confidence that the majority of Republicans would back the bill, with voting expected as early as Wednesday, though there is limited time before the US Treasury's revised 5 June X-date to avoid a default.

► **UK: CPI printed with upside surprise, further hikes expected**

We also see risks of further rate hikes by the BoE following the upside surprise in April CPI data. We were already expecting the BoE to hike by 25 bps at its June and August policy meetings, though we now see the potential need for more tightening. Markets are expecting four 25 bps rate hikes by the end of the year, up from previous expectations of two hikes followed by a pause after the August policy meeting. Inflation decelerated in April to 8.7% y-o-y (March: 10.1%), albeit printing higher than consensus expectations of 8.2%, with core inflation accelerating and raising concerns over sticky price pressures. Core inflation is now sizably above the BoE's May forecast (6.7% y-o-y). The headline decelerated on the back of softening energy inflation, with food prices remaining broadly steady in annual terms. Energy inflation moderated substantially to 12.3% y-o-y in April (March: 40.5%) as the increase in Ofgem energy caps last year, and thus higher utility bills, dropped out of annual calculations. We see energy inflation softening further in the near term as Ofgem recently lowered energy price caps (effective from July) on the back of declining wholesale energy prices. Significantly, core inflation accelerated sharply to a 31-year high of 6.8% y-o-y (March and consensus: 6.2%) due to an acceleration in both the service and goods prices. Overall, the core data points to broad-based and persistent inflationary pressures. The pickup in core goods inflation was partly driven by prices indexed to recent inflation rates, such as phone and broadband contracts. The increase in service inflation has been driven by ongoing strong wage growth and continued post-pandemic demand for recreation and leisure.

► **Oil: OPEC+ to hold status quo in Vienna meeting**

We expect OPEC+ to keep production steady at its 4 June in-person meeting, even after Saudi Arabia's energy minister warned speculators shorting the oil market. We view the minister's comments as verbal intervention targeted at the rise in short positions and supporting the price, with the statement carrying additional weight ahead of an in-person OPEC+ meeting. It also indicated to us that OPEC+ will implement further output cuts going forward, if required. Russian Deputy Prime Minister Alexander Novak also retracted his statement on no further production cuts, acknowledging that 'action could be taken if required'. Novak added that he sees higher summer demand pushing Brent prices slightly above USD80 p/b by year-end. We continue to believe that the 1.16 million barrel production cut being implemented from May will be highly effective and shift global oil balances into a deficit. Nevertheless, we recently reduced our oil price forecast for 2023 on the back of a lower 2Q average, due to weaker-than-expected demand from China and ongoing strong supply from Russia. For more details, please see our note **GCC and Oil: Adjusting our GCC economic estimates for our lower oil price forecasts**, published 18 May 2023. Brent has erased all the

gains made post the surprise OPEC production cut announcement in April. The bearish sentiment in the oil market was reflected in the build-up in speculative short positions from early May, which had risen to the highest in a decade. We assume a Brent price forecast of USD84.3 p/b for 2023, which incorporates an upward move in prices in 2H2023 on tighter global oil fundamentals.

► **Turkey: CBRT holds rates steady ahead of run-off vote**

The CBRT kept rates steady for the third consecutive meeting last week, maintaining the one-week repo rate at 8.5%. This outcome was in line with our and market expectations. Preserving “growth momentum in industrial production” and “supporting recovery in aftermath of the earthquake” underpinned the policy rate pause extension. This decision comes against the backdrop of elevated headline inflation (April: 43.7% y-o-y), albeit decelerating, and deeply negative real interest rates (-35.2%). However, the CBRT removed its previous statement of “closely monitoring the earthquake's impact on macro variables” and instead highlighted that the earthquake will not have a long-term impact on the economy. Provisional media reports show that President Recep Erdogan has secured a new term after receiving c.52.0% of the electoral vote, though the official results of the run-off vote (held on Sunday) will be released on Thursday. The TRY is currently trading at c.20.0 against the USD, close to the record low the currency hit last Friday. Erdogan stressed in a recent interview that there would not be a move away from the current economic model towards conventional monetary policy. In our view, Erdogan's commitment to a heterodox policy mix would necessitate introducing further regulatory measures to limit FX demand and banking sector restrictions. However, Turkey's monetary policy is resulting in falling FX reserves, and further declines could eventually prompt the CBRT to raise the policy rate. We believe that foreign capital would need to see a significant change in policy before returning.

► **Week Ahead: EU CPI, China PMI and India GDP are key**

Markets will continue to closely monitor negotiations on the US debt ceiling revision. On the data front, Eurozone CPI, India's 1Q GDP data and China's official PMI remain the key releases this week. EU headline inflation is expected to decelerate to 6.3% y-o-y (April: 7.0%) on the back of a decline in energy inflation (base-effect driven) and food prices. Core inflation should also moderate marginally to 5.5% y-o-y (April: 5.6%) as the decline in energy prices filters into core goods.

Consensus expects May PMI for China to show manufacturing activity (49.5) continued to contract, albeit by a smaller magnitude (April: 49.2). Meanwhile, India's 1Q2023 GDP growth is forecast to accelerate to 5.0% y-o-y (4Q2022: 4.4%) on stronger farm output and a limited drag from net exports with strong services exports. A 1Q2023 GDP print in line with consensus would keep the economy on track to reach full-year growth of above 7.0% in FY2022-23 (April-March). Overall, high-frequency data points to broad economic resilience, though tighter financial conditions, waning consumption demand and a weaker export outlook should pull down growth to 6.5% y-o-y in FY2023-24 (April-March).

## I. Economic Calendar

Fig. 1. The week ahead

Time*	Country	Event	Period	Prior	Consensus
<b>Expected this week</b>					
	UAE	M3 Money Supply, y-o-y	Mar	14.0%	
<b>Monday, 29 May</b>					
9:00	Japan	Leading Index, CI	Mar F	97.5	
9:00	Japan	Coincident Index	Mar F	98.7	
<b>Tuesday, 30 May</b>					
3:30	Japan	Jobless Rate	Apr	2.8%	2.7%
3:30	Japan	Job-To-Applicant Ratio	Apr	1.32	1.32
12:00	Eurozone	M3 Money Supply, y-o-y	Apr	2.5%	2.0%
18:00	US	Conf. Board Consumer Confidence	May	101.3	99.0
<b>Wednesday, 31 May</b>					
3:50	Japan	Retail Sales, y-o-y	Apr	7.2%	7.1%
3:50	Japan	Industrial Production, m-o-m	Apr P	1.1%	1.3%
5:30	China	Manufacturing PMI	May	49.2	49.5
5:30	China	Non-manufacturing PMI	May	56.4	55.3
11:55	Germany	Unemployment Change, (000's)	May	24.0K	15.0K
15:00	US	MBA Mortgage Applications	26-May	-4.6%	
16:00	India	GDP, y-o-y	1Q	4.4%	5.0%
16:00	Germany	CPI, m-o-m	May P	0.4%	0.2%
16:00	Germany	CPI, y-o-y	May P	7.2%	6.4%
17:15	UK	BOE's Mann speaks			
17:45	US	MNI Chicago PMI	May	48.6	47.2
<b>Thursday, 1 June</b>					
3:50	Japan	Capital Spending, y-o-y	1Q	7.7%	5.4%
4:30	Japan	Jibun Bank Japan PMI Mfg	May F	50.8	
5:45	China	Caixin China PMI Mfg	May	49.5	49.5
9:00	India	S&P Global India PMI Mfg	May	57.2	
11:55	Germany	HCOB Germany Manufacturing PMI	May F	42.9	42.9
12:00	Eurozone	HCOB Eurozone Manufacturing PMI	May F	44.6	44.6
12:30	UK	Mortgage Approvals	Apr	52.0K	
12:30	UK	S&P Global/CIPS UK Manufacturing PMI	May F	46.9	46.9
13:00	Eurozone	CPI, m-o-m	May P	0.6%	0.2%
13:00	Eurozone	Unemployment Rate	Apr	6.5%	6.5%
13:00	Eurozone	CPI Estimate, y-o-y	May	7.0%	6.3%
13:00	Eurozone	CPI Core, y-o-y	May P	5.6%	5.5%
16:15	US	ADP Employment Change	May	296K	165K
16:30	US	Initial Jobless Claims	27-May	229K	235K
16:30	US	Continuing Claims	20-May	1794K	1803K
17:45	US	S&P Global US Manufacturing PMI	May F	48.5	48.5
18:00	US	Construction Spending, m-o-m	Apr	0.3%	0.2%
18:00	US	ISM Manufacturing	May	47.1	47.0
18:00	US	ISM Prices Paid	May	53.2	52.5
<b>Friday, 2 June</b>					
3:50	Japan	Monetary Base, y-o-y	May	-1.7%	
16:30	US	Change in Nonfarm Payrolls	May	253K	190K
16:30	US	Two-Month Payroll Net Revision	May	-149K	
16:30	US	Unemployment Rate	May	3.4%	3.5%
16:30	US	Average Hourly Earnings, m-o-m	May	0.5%	0.3%
16:30	US	Average Hourly Earnings, y-o-y	May	4.4%	4.4%
16:30	US	Labor Force Participation Rate	May	62.6%	62.6%

\*UAE time

Source: Bloomberg, ADCB Economic Research

Fig. 2. Last week's data

Time*	Country	Event	Period	Prior	Consensus	Actual
<b>GCC Economies</b>						
	Qatar	Trade Balance Month	Apr	21273M		22001M
	Kuwait	CPI, y-o-y	Apr	3.7%		
	Bahrain	CPI, y-o-y	Apr	-0.1%		
<b>Monday, 22 May</b>						
3:50	Japan	Core Machine Orders, m-o-m	Mar	-4.5%	0.4%	-3.9%
18:00	Eurozone	Consumer Confidence	May P	-17.5	-16.8	-17.4%
<b>Tuesday, 23 May</b>						
11:30	Germany	HCOB Germany Manufacturing PMI	May P	44.5	45.0	42.9
11:30	Germany	HCOB Germany Services PMI	May P	56.0	55.0	57.8
12:00	Eurozone	HCOB Eurozone Manufacturing PMI	May P	45.8	46.0	44.6
12:30	UK	S&P Global/CIPS UK Manufacturing PMI	May P	47.8	48.0	46.9
12:30	UK	S&P Global/CIPS UK Services PMI	May P	55.9	55.3	55.1
12:30	UK	S&P Global/CIPS UK Composite PMI	May P	54.9	54.6	53.9
17:45	US	S&P Global US Manufacturing PMI	May P	50.2	50.0	48.5
17:45	US	S&P Global US Services PMI	May P	53.6	52.5	55.1
17:45	US	S&P Global US Composite PMI	May P	53.4	53.0	54.5
18:00	US	New Home Sales	Apr	683K	665K	683K
18:00	US	Richmond Fed Manufact. Index	May	-10.0	-8.0	-15.0
<b>Wednesday, 24 May</b>						
10:00	UK	CPI, m-o-m	Apr	0.8%	0.7%	1.2%
10:00	UK	CPI, y-o-y	Apr	10.1%	8.2%	8.7%
10:00	UK	CPI Core, y-o-y	Apr	6.2%	6.2%	6.8%
10:00	UK	RPI, m-o-m	Apr	0.7%	1.2%	1.5%
12:00	Germany	IFO Business Climate	May	93.6	93.0	91.7
12:00	Germany	IFO Expectations	May	92.2	91.6	88.6
15:00	US	MBA Mortgage Applications	19-May	-5.7%		-4.6%
<b>Thursday, 25 May</b>						
10:00	Germany	GDP SA, q-o-q	1Q F	0.0%	0.0%	-0.3%
16:30	US	Initial Jobless Claims	20-May	242K	245K	229K
16:30	US	GDP Annualized, q-o-q	1Q S	1.1%	1.1%	1.3%
16:30	US	GDP Price Index	1Q S	4.0%	4.0%	4.2%
18:00	US	Pending Home Sales, m-o-m	Apr	-5.2%	1.0%	0.0%
<b>Friday, 26 May</b>						
3:30	Japan	Tokyo CPI ex-Fresh Food, y-o-y	May	3.5%	3.4%	3.2%
10:00	UK	Retail Sales Inc Auto Fuel, m-o-m	Apr	-0.9%	0.3%	0.5%
10:00	UK	Retail Sales Inc Auto Fuel, y-o-y	Apr	-3.1%	-2.8%	-3.0%
10:00	UK	Retail Sales ex-Auto Fuel, m-o-m	Apr	-1.0%	0.4%	0.8%
10:00	UK	Retail Sales ex-Auto Fuel, y-o-y	Apr	-3.2%	-2.8%	-2.6%
16:30	US	Personal Income	Apr	0.3%	0.4%	0.4%
16:30	US	Personal Spending	Apr	0.0%	0.5%	0.8%
16:30	US	PCE Deflator, m-o-m	Apr	0.1%	0.3%	0.4%
16:30	US	PCE Deflator, y-o-y	Apr	4.2%	4.3%	4.4%
16:30	US	PCE Core Deflator, m-o-m	Apr	0.3%	0.3%	0.4%
16:30	US	PCE Core Deflator, y-o-y	Apr	4.6%	4.6%	4.7%
16:30	US	Wholesale Inventories, m-o-m	Apr P	0.0%	0.0%	-0.2%
16:30	US	Durable Goods Orders	Apr P	3.2%	-1.0%	1.1%
16:30	US	Durables ex-Transportation	Apr P	0.2%	-0.1%	-0.2%
18:00	US	U. of Mich. Sentiment	May F	57.7	58.0	59.2

\*UAE time

Source: Bloomberg, ADCB Economic Research

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