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Macro Insights Weekly

Odd case of US disinflation and surging growth

Economics & Strategy Research

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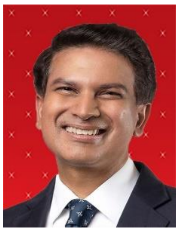


Taimur Baig
Chief Economist
taimurbaig@dbs.com

Nathan Chow
Senior Economist / Strategist
nathanchow@dbs.com

For Alliance Bank clients, please direct your enquiries to
Malaysia Research +603 2604 3915 general@alliancedbs.com

- *Defying substantial interest rate hikes, the US economy is on course to mark a historically strong third quarter. Currently, real growth for the quarter is tracking 4-5%+*
- *Consumption, investment, and housing are either holding firm or rebounding.*
- *We don't think more rate hikes are coming, but we think rate cuts are far.*
- *Strong growth and surging rates have yet to dent dollar funding or credit conditions.*
- *Inflation is waning, reflecting supply chain normalisation and Fed hikes.*
- *The Fed wants the market to believe "higher for longer"; this is unlikely to help equities.*

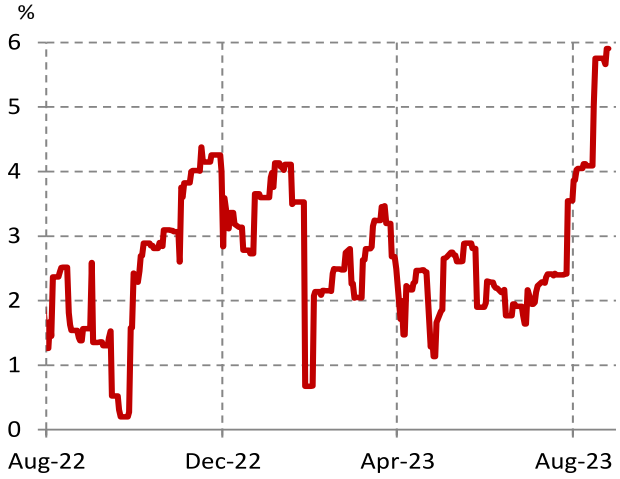
Key data release and events this week:

- *China's Manufacturing PMI is projected to decrease from 49.3 in July to 49.0 in August.*
- *Exports of S.Korea might decline by 16% in August, largely on par with rate seen in July.*
- *Vietnam's exports likely shrank for the sixth straight month.*

Chart of the Week: US growth spurt in 3Q

Defying substantial interest rate hikes, the US economy is on course to mark a historically strong third quarter. Atlanta Fed's GDPNow model is tracking 5.9% real GDP growth (seasonally adjusted annualised rate), reflecting surging fixed asset investment, rebound in home building, and sustained tightness in labour markets. The typically more conservative New York Fed Nowcasting model is estimating close to 4% growth. With inflation waning at the same time, this is just about as good as it gets for the US.

US GDP Nowcast (Atlanta Fed)



Source: Bloomberg, DBS

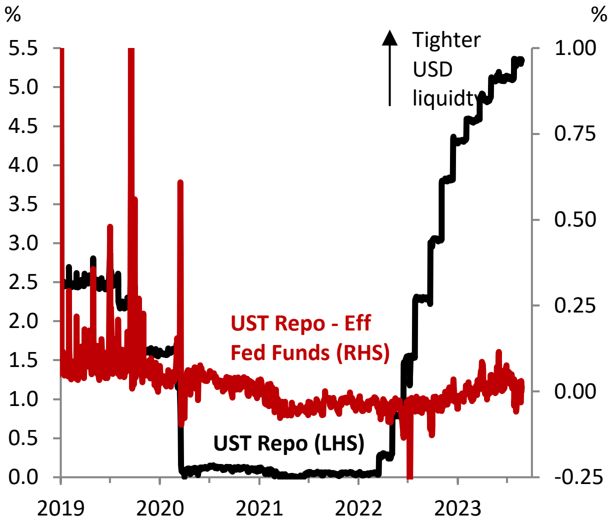
Commentary: Odd case of US disinflation and surging growth

During his Jackson Hole address last week, US Fed Chair Powell was careful not to declare victory over inflation, stressing that disinflation process has a long way to go. But he was also comfortable in signalling that the 500bps+ rate hikes in this cycle have given the Fed space to watch developments as opposed to pursuing a strident path of additional rate hikes.

It would be understandable if Fed officials are not spending too much time fretting about the outlook. At this juncture, the US economy is characterised by a remarkable mix of strong growth and waning inflation, stable funding conditions and financial stability, robust labour market and improving consumer plus business sentiments. This is just about as good as it gets.

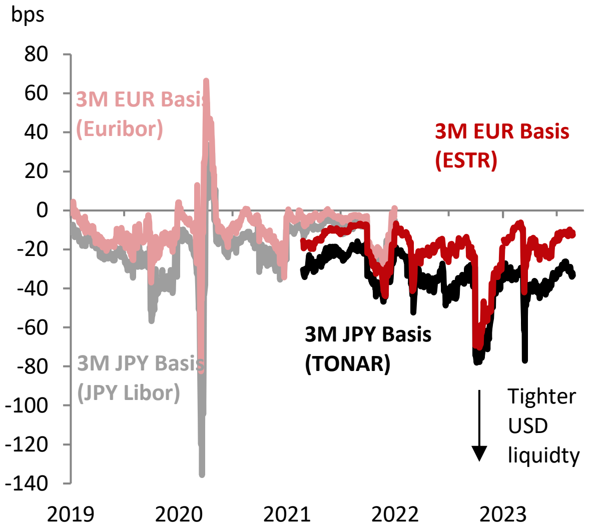
Some regional bank failures earlier this year notwithstanding, along with sustained distress in the commercial real estate market, USD funding conditions, locally and internationally, remain favourable. The dollar has become considerably more expensive, but that hasn't affected its supply/demand conditions.

Tightness of USD Funding - Repo



Source: Bloomberg, DBS

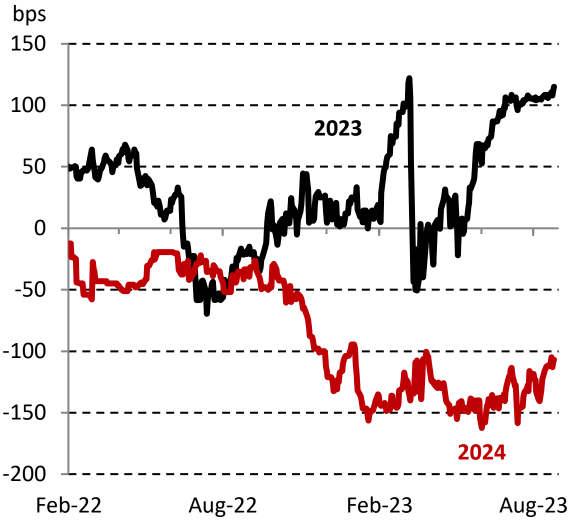
Tightness of USD Funding - Cross Currency



Source: Bloomberg, DBS

The Jackson Hole speech's cautious tone, in our view, was meant less to suggest that more rate hikes are coming, and more to prevent the market from getting excited about the timing of eventual rate cuts. Looking at market pricing, there are still some bets on additional rate hikes this year, which we think will prove to be wrong. As for next year's pricing, we are in line with the view that about 100bps in rate cuts can be expected in 2H24, by which time growth would be substantially lower, along with hardly any risk of inflation rebound.

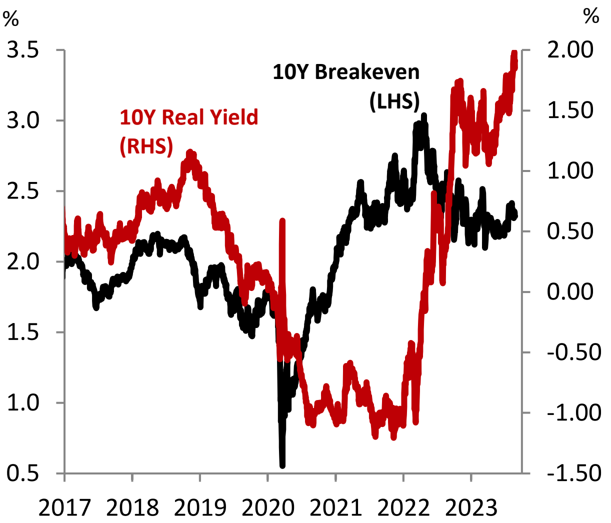
Pricing for Fed Hikes(+)/Cuts(-)



Source: Bloomberg, DBS

What would drive growth lower? The ingredients are already in place. As Chair Powell noted in his speech, bank lending standards have tightened, and industrial production growth has slowed. Higher cost of borrowing will incur pain on consumer and business loans eventually, even though so far the economy has absorbed the interest shock quite well.

10Y US Real Yield vs Inflation Compensation

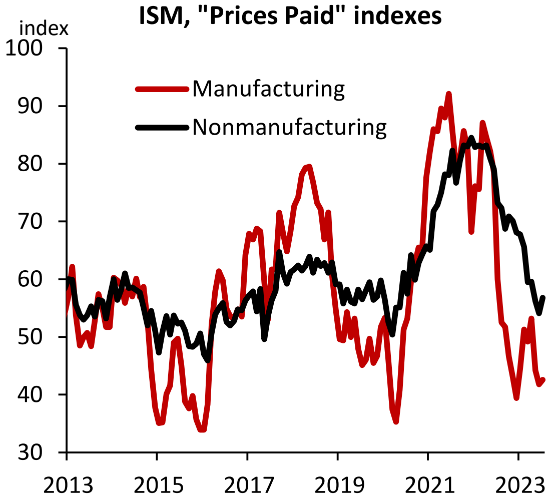


Source: Bloomberg, DBS

Looking at 2% real yield on 10-year treasuries, we are sure that growth slowdown is in the pipeline for 2024, if not in 4Q23. We are impressed by the resiliency of the US housing market, but we think it is just a matter of time before the market cools, with 30-yr mortgage rates heading toward 7.3% last week.

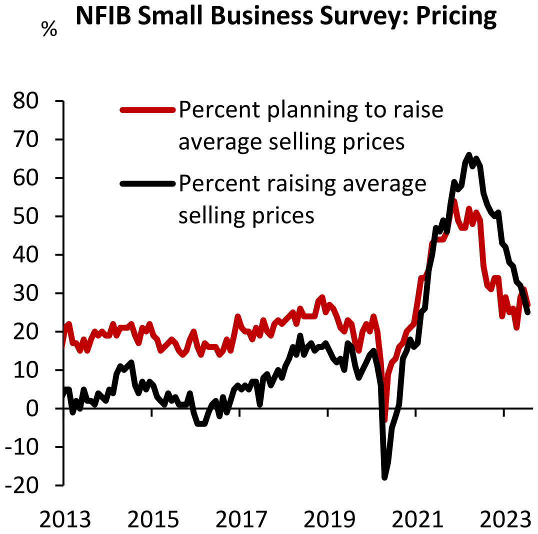
The unwinding of pandemic distortions and the Fed's rate increases are now working together to bring down inflation. China's slowdown is another source of global disinflationary impulse. But if the Fed succeeds in keeping the market from expecting rate cuts any time soon, it would cause some financial market stress, especially in equities, in our view. The odd mix of resilient growth, falling inflation, and high interest rates can only last for so long.

ISM, "Prices Paid" indexes



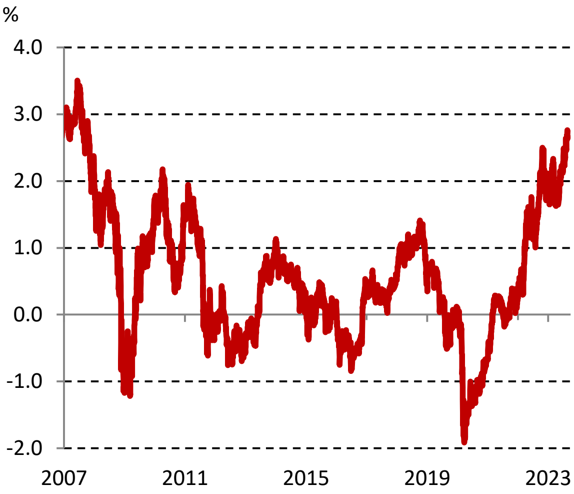
Soure: CEIC, DBS. Data through July 2023

NFIB Small Business Survey: Pricing



Soure: CEIC, DBS. Data through July 2023

10Y UST yield - SP500 Dividend yield



Source: Bloomberg, DBS

Taimur Baig

Key forecasts for the week

Event	DBS	Previous
Aug 29 (Tue)		
Vietnam: exports (Aug)	-11.0% y/y	-3.5% y/y
- imports	-12.3% y/y	-9.9% y/y
- trade balance	USD2.5bn	USD2.2bn
- Retail sales YoY YTD	10.0% y/y	10.4% y/y
- CPI	2.5% y/y	2.1% y/y
Aug 31 (Thu)		
China: manufacturing PMI (Aug)	49.0	49.3
Hong Kong: retail sales (Jul)	20.0% y/y	19.6% y/y
Eurozone: CPI (Aug)	4.8% y/y	5.3% y/y
Japan: industrial production (Jul)	-0.3% m/m sa	2.4% m/m sa
South Korea: industrial production (Jul)	0.3% m/m sa	-1.0% m/m sa
India: GDP (2Q23)	7.5% y/y	6.1% y/y
Sep 1 (Fri)		
South Korea: exports (Aug)	-16.0% y/y	-16.4% y/y
- imports	-25.8% y/y	-25.4% y/y
- trade balance	-$1423mn	$1652mn
Indonesia: CPI (Aug)	3.2% y/y	3.1% y/y

Forthcoming data releases

China: The Manufacturing PMI is projected to decrease from 49.3 in July to 49.0 in August due to slowdown in economic conditions. On the external front, demand from key trading partners is diminishing. Both the US and Eurozone Manufacturing PMIs have fallen below the expansion threshold of 50 for 9 and 14 consecutive months, respectively. This is due to the impact of rate hikes, which are translating into a weaker growth momentum. The Manufacturing PMI of ASEAN, China's top trading partner, has also decreased to a nearly two-year low of 50.8.

Meanwhile, domestic demand is weakening. The gradual decrease in overall fixed asset investment indicates a further contraction in production activities. Meanwhile, the persistent stress in the property market is putting pressure on demand for consumables through negative wealth effects, thereby constraining production demand.

Hong Kong SAR: Retail sales were expected to have increased by 20.0% YoY in July, closely resembling the 19.6% growth seen in June. Despite a favorable number of Mainland visitor arrivals coinciding with the onset of the summer holiday season (reaching around 80% of pre-COVID levels), the spending capacity was likely hampered by the weakened RMB exchange rate. Concurrently, local consumers are hoarding for future outbound travel, particularly to Shenzhen, driven by the strengthening of the HKD. It's worth noting that there is a strong inverse correlation of nearly -70 between Hong Kong's retail sales growth and the RMB exchange rate.

South Korea: Trade and production data are due this week. Based on the initial figures, exports might experience a YoY decline of about -16% in August, similar to the rate seen in July. After two consecutive months of surplus, trade balance is expected to shift back into a modest deficit. The momentum behind export recovery remains unsettled. The initial upswing attributed to increased automobile exports has diminished since July. While there are signs of a slower decline in semiconductor exports, a significant rebound is not yet on the horizon. Encouragingly, there has been an acceleration in destocking, leading to the substantial digestion of excess inventories. As such, industrial production is likely to avoid a sharper contraction and achieve stabilization in July.

Vietnam: Vietnam’s external challenges are likely to be reflected in Aug 2023’s high frequency figures. Goods exports likely shrank for the sixth straight month, with the decline widening to 11.0% YoY, amid more adverse base effects vs last month. Retail sales, meanwhile, likely expanded at a steady clip, providing buffer to the economy, even though growth has eased to the pre-pandemic pace.

Headline CPI inflation stayed well below the central bank’s 4.5% target for 2023, but Aug’s rate likely ticked up to 2.5% YoY. Core and food inflation remained on a downtrend, keeping overall inflation contained. Yet, transportation subtracted less from headline inflation, as domestic oil prices inched higher from last month at a faster pace. On risks, food prices face upside risks from El Nino, while the Vietnamese dong has weakened vs the USD since June. The central bank's room for additional monetary easing appears to be narrowing.

India: The new fiscal year FY24 likely kicked off on a strong note, led by the demand drivers, besides base effects. Consumption is expected to have fared better in Apr-Jun23, as reflected in the pickup in durables output, auto sales and personal credit growth, helped also by a boost to purchasing power due to a deceleration in inflation. Construction activity also likely gathered momentum ahead of the southwest monsoon, with the broader manufacturing output upheld by key input-industries. Corporate performance in the quarter pointed to a sharp pick up in profits, though not broad-based. This reflected a cooling-off in input costs, whilst sales growth eased. Net exports are expected to have lost momentum as final demand weakened across key trading partners, including US, Europe and Asia. This prevented a material improvement in the trade balance shortfall despite a narrower import bill due on favourable terms of trade dynamics.

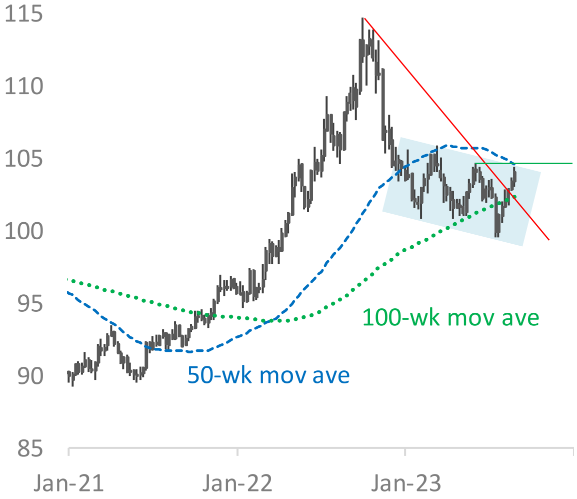
Indonesia: Base effects might keep Indonesia's inflation steady in Aug from the month before, yet prints are on a steady decelerating path. We expect inflation to slip to sub-3% by Sep when inflation had peaked at the comparable period last year due to subsidy price adjustments. Bank Indonesia has continued to maintain that stability in the currency and financial markets are of paramount importance, nudging them to keep rates unchanged despite inflation returning to the target range.

Economics Team

FX: DXY is data-dependent this week

DXY appreciated a sixth week by 0.7% to 104.1 last Friday, back inside the 101-106 range set in 1H23. Apart from recovering all its early July sell-off, DXY hit its highest level since June and was up 0.5% for the year. **To extend its rally, DXY need to break above its 104.7**, the meeting point of several technical resistances marked by its 50-week moving average, a price channel, and its end-May peak. Conversely, the DXY must hold above 102.3 (100-wk MA) to maintain its upward momentum.

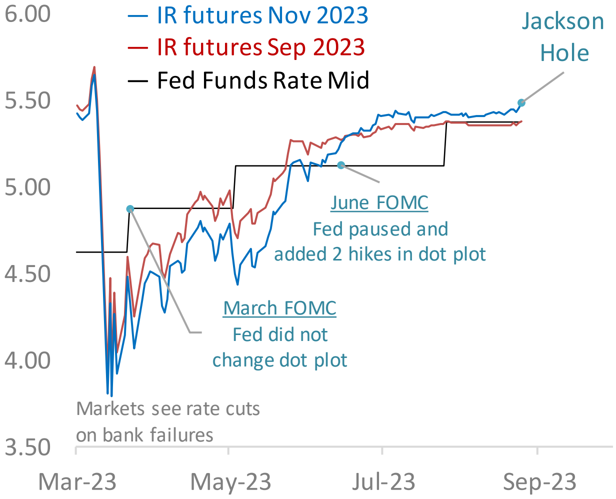
DXY to rally if it breaks above 104.7



Sources: DBS Research, Bloomberg data

Fed Chair Jerome Powell's speech at Jackson Hole left the door open for a rate hike later this year. July's hike was one of the two rate increases projected in June's Summary of Economic Projections. The Fed is attentive to signs that the US economy may not be cooling as expected, with the housing sector also picking up again. Powell also reaffirmed the Fed's commitment to 2% as the inflation target. Although the Fed considers monetary policy restrictive, it could not identify with certainty the neutral rate of interest, i.e., the precise level of policy restraint.

Futures see possible Fed hike in November



Sources: DBS Research, Bloomberg data

Against this background, the Fed ruled out rate cuts this year and would look at the "totality of data" to decide between a hike or pause at the next FOMC meetings. **Interest rate futures think any hike is more likely in November than September** because of the advance GDP report in October. But **markets can bring forward expectations if this Thursday's US PCE deflators and this Friday's monthly jobs report surprise**, affirming the Fed's belief that inflation has become more responsive to labour market tightness than before. Based on the rebound in US CPI three weeks earlier, consensus expects headline inflation to rise to 3.3% YoY in July from 3% in June and core inflation to 4.2% from 4.1%. However, the Fed will look for more than 0.2% MoM increases to affirm the upside inflation risks highlighted in the FOMC minutes. Similarly, the Fed's trigger finger will get itchy if nonfarm payrolls return above 200k in August for the first time in three months alongside a low jobless rate and wage increases holding above the inflation target.

Philip Wee

Group Research

Economics & Macro Strategy

Taimur Baig, Ph.D.
Chief Economist
Global
taimurbaig@dbs.com

Chang Wei Liang
FX & Credit Strategist
Global
weiliangchang@dbs.com

Nathan Chow
Senior Economist
China, Hong Kong SAR
nathanchow@dbs.com

Chua Han Teng, CFA
Economist
Asean
hantengchua@dbs.com

Violet Lee
Associate
Publications
violetleeyh@dbs.com

Eugene Leow
Senior Rates Strategist
G3 & Asia
eugeneleow@dbs.com

Chris Leung
Chief Economist
China, Hong Kong SAR
chrisleung@dbs.com

Ma Tieying, CFA
Senior Economist
Japan, South Korea, Taiwan
matieying@dbs.com

Radhika Rao
Senior Economist
Eurozone, India, Indonesia
radhikarao@dbs.com

Irvin Seah
Senior Economist
Singapore
irvinseah@dbs.com

Daisy Sharma
Analyst
Data Analytics
daisy@dbs.com

Duncan Tan
Rates Strategist
Asia
duncantan@dbs.com

Samuel Tse
Economist
China, Hong Kong SAR
samueltse@dbs.com

Philip Wee
Senior FX Strategist
Global
philipwee@dbs.com

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DBS Bank (Hong Kong) Limited, a company incorporated in Hong Kong with limited liability. 13th Floor One Island East, 18 Westlands Road, Quarry Bay, Hong Kong SAR

AllianceDBS Research Sdn Bhd (128540 U), 19th Floor, Menara Multi-Purpose, Capital Square, 8 Jalan Munshi
Abdullah, 50100 Kuala Lumpur, Malaysia. Tel.: +603 2604 3915.

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