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DBS

Macro Insights Weekly

What to make of the US treasury selloff

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- *The treasury market sell-off has coincided with easing core inflation and stricter control on US government spending. This vexing development is putting broader asset markets at risk.*
- *US core inflation continues to ease, although rising oil has made the headline inflation sticky.*
- *Between shutdown posturing and expiration of pandemic-era support, fiscal slippage isn't a concern.*
- *Yet, bond yields rose sharply last quarter. This can readily spill over into spreads.*
- *A sharp repricing raises the risk of economic pain and financial instability.*
- *Hopes of a soft landing in 2024 may well be dashed.*

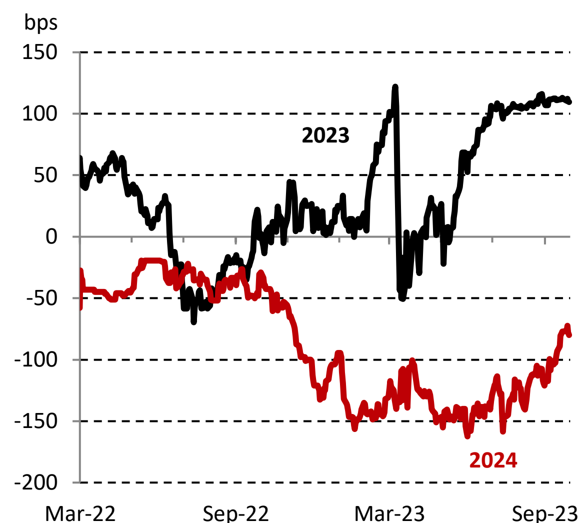
Key data release and events this week:

- *RBI should maintain its hawkish pause give above target inflation.*
- *Indonesia's inflation is likely to ease sharply on base effects*
- *Taiwan's inflation should hold steady amid elevated food prices*

Chart of the Week: Fickle "smart money"

The fixed income market is generally considered "smart," with deep institutional position-taking underpinning its pricing. But looking at the behaviour of Fed funds futures this year, the fickleness is striking. The markets have gyrated from pricing hikes to cuts to hikes in 2023, and from a recession in 2024 with at least 100bps in rate cuts to "high for longer." We are maintaining a steady call; no further hikes this year, and 100bps in cuts in 2H24.

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



Source: Bloomberg, DBS

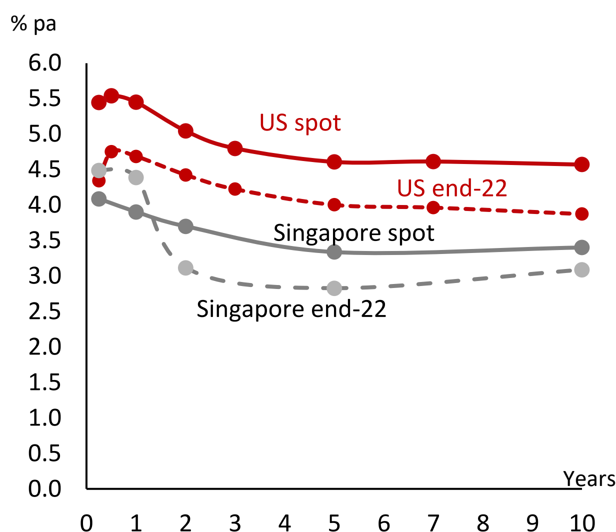
Refer to important disclosures at the end of this report.

Commentary: What to make of the US treasury market selloff

Perhaps the markets are finally coming to terms with the no-recession-in-the-near-term scenario; perhaps the Fed's communication through its dot-plots is finally getting through; the US fixed income market sold off considerably in the third quarter. 30-yr treasury yields rose by a remarkable 89bps during July-September, while curve inversion has eased substantially, with the 2yr-10yr spread going from -108bps at the beginning of July to -47bps at the end of September. These developments are causing, for the first time in this cycle, genuine tightening of financing conditions. Another way of looking at the dynamic is the 10-year real yield, which, at well over 2%, is likely to put knock-on strain on corporate debt refinancing, the mortgage market, and the servicing of an additional assortment of consumer loan products.

The transmission from US rates to Asia has been substantial. Singapore's 10-year bond yield, rose by 32bps during the quarter, a sizeable jump. The USD govt bond yield of Indonesia and the Philippines have risen by 60-100bps.

US and Singapore Treasury yield curves

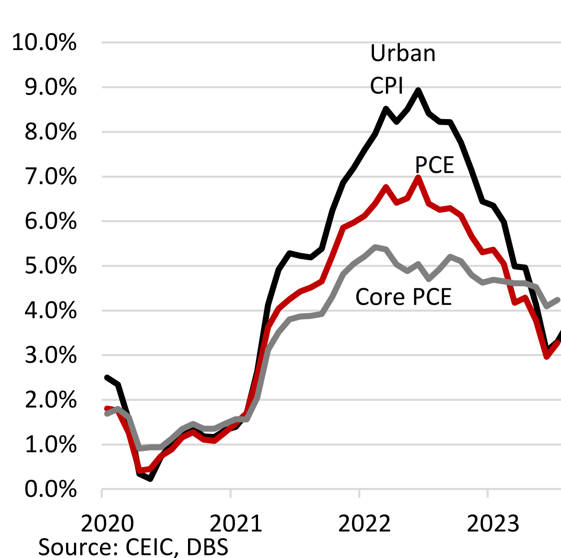


Source: Bloomberg, DBS

In a way, the developments are vexing. Inflation has been easing worldwide, some marginal pressure on headline readings due to rebounding food and fuel prices notwithstanding. Bond supply worries should be declining, not rising, as pandemic era support measures are wound down. Demand-side pull from inflation is also beginning to dissipate, as high rates begin to slow down private consumption, company margins, and, by extension, business hiring.

The market may be gyrating from utter comfort to excessive worry about the outlook for inflation and bond supply, the effect of this could be far reaching and destabilizing. From equities to corporate credit to private debt, a sharp repricing would raise the risk of economic pain and financial instability. That in turn would bring back the specter of recession next year, causing curves to rotate downward in anticipation. But by then, the damage might be done, and hopes of a soft landing would be dashed. Stepping into the final quarter of 2023, that's the risk we need worry about.

US inflation, various measures



Source: CEIC, DBS

Taimur Baig

Key forecasts for the week

Event	DBS	Previous
Oct 2 (Mon)		
Indonesia: CPI (Sep)	2.2% y/y	3.3% y/y
Oct 4 (Wed)		
South Korea: industrial production (Aug)	0.2% m/m sa	-2.0% m/m sa
Oct 5 (Thu)		
South Korea: CPI (Sep)	3.4% y/y	3.4% y/y
Philippines: CPI (Sep)	5.5% y/y	5.3% y/y
Thailand: CPI (Sep)	1.3% y/y	0.9% y/y
Taiwan: CPI (Sep)	2.4% y/y	2.5% y/y
Oct 6 (Fri)		
India: RBI repurchase rate	6.50%	6.50%
US: Non farm payrolls	180k	187k

Central bank policy meetings

Reserve Bank of Australia (RBA) (Oct 3): Look for Michele Bullock to maintain a hawkish pause at her first policy meeting as the new RBA Governor; the cash rate target should remain unchanged at 4.10% for a fourth month. Although CPI inflation rose to 5.2% YoY in August from 4.9% in July, the unemployment rate held the year's high of 3.7% in July and August. The Albanese government released a white paper highlighting the shortfall in the RBA's definition of full employment. Treasurer Jim Chalmers warned that a soft landing for the Australian economy was not assured because of past hikes and China's economic slowdown. While GDP growth slowed a third quarter to 2.1% YoY in 2Q23 from its peak of 6% in 3Q22, the seasonally adjusted per capita GDP contracted QoQ in four out of the past five quarters. The consumer continues to struggle from a cost-of-living crisis amid the worst housing affordability in 30 years.

Reserve Bank of New Zealand (RBNZ) (Oct 4): RBNZ should keep the official cash rate (OCR) unchanged at 5.50% for a third meeting with a hawkish stance. The NZ Institute of Economic Research (NZIER) expects the 525 bps of hikes since October 2021 to subdue economic growth at 0.4% in FY23/24 and 1.1% in FY24/25. Despite interest rate futures not ruling another hike, we are siding with economists predicting rate cuts next year on a weak economy and inflation returning to the 0-3% target by 3Q24.

RBNZ Meeting Monitor

			Consensus		
MPC	**OCR**	**bps ch**	**OCR**	**CPI***	**GDP***
22 Feb 2023	4.75	+50		6.7	2.2
5 Apr 2023	5.25	+50		6.0	1.8
24 May 2023	5.50	+25			
12 Jul 2023	Pause	--		*5.6*	*-0.5*
16 Aug 2023	Pause	--			
4 Oct 2023	***5.52***		*5.50*	*4.7*	*-0.2*
29 Nov 2023	*5.64*				
28 Feb 2024	*5.75*		*5.40*	*5.4*	*0.1*
10 Apr 2024	*5.72*		*5.10*	*3.4*	*0.6*
22 May 2024	*5.73*				
10 Jul 2024	*5.68*		*4.75*	*2.6*	*0.7*
14 Aug 2024	*5.80*				
9 Oct 2024	--		*4.35*	*2.4*	*1.5*
27 Nov 2024	--				

Bold italics are implied OIS futures as of 29 Sep 2023

* % yoy RBNZ inflation target: 0% to 3%

Sources: DBS Research, Bloomberg data/consensus

Reserve Bank of India (RBI) (Oct 6): Please see the next section for the detailed preview note.

Forthcoming data releases

Indonesia and Philippines: Indonesia's headline inflation is expected to ease sharply from 3.3% to 2.2% yoy in September, influenced by base effects (subsidized fuel prices were hiked last year). Core inflation is also likely to stay benign at ~2.1% yoy. While the BI takes comfort from easing inflation, the government has sought to take more administrative measures to keep a lid on cost pressures, especially for rice. Rupiah weakness remains a thorn on the side of the policymakers (-3% vs USD in 3Q). Philippines' inflation is expected to stay firm at 5.5% yoy as food and fuel besides cost push factors like minimum wage increases underpin price pressures. The BSP has expressed its readiness to hike rates if circumstances warrant. Authorities will remain on hold, to balance between upside risks in inflation and downside in growth.

South Korea: CPI inflation is expected to continue its elevated trend, reaching 3.4% YoY in September. This rise can be attributed to the Chuseok festival, increasing oil prices, and volatility in food prices. In contrast, industrial production is anticipated to exhibit a modest improvement, with a forecasted -5.5% YoY in August, up from -8.0% in the prior month. Exports have shown signs of recovery, with a decline of only -4.4% YoY in September, the smallest decrease in the past 12 months. Despite the persistent inflation, the BOK is unlikely to respond, as core CPI remains relatively stable and economic growth recovery remains uncertain. The next potential policy move is still expected to be a rate cut, assuming that supply-side disruptions impacting inflation are temporary and that CPI figures will retreat below 3% starting from 1Q24 onwards.

Taiwan: CPI inflation is expected to hold steady at 2.4% YoY in September, following a slight rebound to 2.5% in August. The persistence of elevated food prices can be attributed to factors such as typhoons and the mid-Autumn festival. Additionally, transportation fees may experience an uptick due to higher global oil prices and a strong US dollar. During the most recent MPC meeting in September, the central bank expressed concerns regarding the potential for inflation to remain within the 1.5-2% range over the long term. These developments align with our expectation that the CBC will refrain from reducing interest rates, even in light of the possibility of Fed easing in 2024. Our forecast remains consistent with the CBC maintaining the discount rate at its current level of 1.875% for the remainder of this year and throughout 2024.

Thailand: Thailand's headline inflation has likely bottomed out. We expect it to return to the Bank of Thailand (BOT)'s 1-3% inflation target in Sep 2023, rising by 1.3% YoY. The increase was mainly driven by rising energy inflation. Energy turned from drag to driver starting from Aug 2023, amid rising global oil prices, spurred by OPEC+ supply cuts. Raw food inflation likely stayed contained due to last year's high base, but face upside risks from El Nino weather disruptions. Core inflation likely remained below the BOT's inflation target, helped by last year's high base. Policymakers are likely to be vigilant on pipeline inflation risks from commodity prices and stimulative government policies. The BOT is therefore, likely to keep interest rates high-for-longer, after signaling that interest rates are at an 'appropriate' level, after hiking by 200bps since Aug 2022.

Economics Team

India: RBI policy preview

The RBI monetary policy committee (MPC) is expected to extend its hawkish pause and keep the ‘withdrawal of accommodation’ stance, at the upcoming policy review on October 6.

Policymakers will weigh global (oil and US dollar) and domestic (inflation, monsoon, growth indicators) developments since the last review. Global crude prices have surged to Nov22 highs, moving above the RBI’s April estimate of $85bl, with Sep’s average about 9% higher Aug. At the same time, US dollar has appreciated sharply on the back of favourable rate and growth differentials vs other G3 countries, keeping INR on a weakening path.

Domestic developments have been mixed. August inflation had retreated from high but was still above target at 6.8% yoy from 7.4% in July, led by a retracement in vegetables (-6% MoM vs +38% in Jul). The broader food basket (ex-vegetables) however stayed firm, amidst a hand over from ‘temporary’ to ‘sticky’ pressures in cereals, sugar, pulses, and spices Encouragingly, underlying pressures continued to ease, with core at 4.8% yoy and core-core (ex- food, fuel, transport, precious metals) at 5%.

Monsoon regained momentum at the tail end of the southwest season in Sep after an over 30% shortfall in Aug (*India: Weather, inflation, growth*), helping to narrow the cumulative rainfall deficit to ~6% at last check. Kharif sowing is nearly flat on the year, with a slight increase in paddy but fall in the acreage under pulses. Concurrently, growth indicators point towards relative resiliency, including power demand, railway freight, and PMIs while inflation-driven nominal data including direct tax collections, credit growth and GST inflows moderate.

We don’t expect the RBI MPC to revise its economic projections from the current 6.5% yoy for growth and 5.4% for CPI inflation. **Perishable food is expected to decelerate further in Sep23** on administrative measures, including higher imports, export restrictions, better inter-state supplies, and release from buffers. Non-food should also find relief from a cut in the cooking gas prices as well as a moderating core.

Despite the favourable price trend, inflation is still above the 4% target, with the MPC likely to be mindful of risks to the price outlook from sticky food segments, lower reservoir levels and developing El Nino (as the winter crop approaches), besides a rise in global oil prices. Spillover will be more apparent in the tradables-sensitive WPI inflation, while a pass-through to consumer retail fuel is less probable in a pre-election year. If oil prices continue to climb or remain at elevated levels due to OPEC supply cuts, the fiscal and current account math are likely to feel the additional burden from a heftier import bill (renewed discounts from Russia will help at the margin).

With inflation still above the target, the RBI MPC is on course to maintain a hawkish pause in October, besides keeping liquidity tight. The RBI’s constructive view on growth and uncertainty over the level of US terminal rates are likely to keep the policy committee from exploring rate cuts this fiscal year.

Radhika Rao

FX: DXY recovery intact, Europe stays weak

It is business as usual now that US President Joe Biden and the US Congress passed a short-term stopgap measure and averted a government shutdown. **This Friday's US nonfarm payrolls and next Thursday's CPI inflation are in play before the FOMC meeting** on 1 November. Consensus expects US nonfarm payrolls to slow to 165k in September from 187k in August and headline inflation to slow to 3.6% YoY (0.3% MoM) in September from 3.7% YoY (0.6% MoM) in August.

Fed officials speaking this week

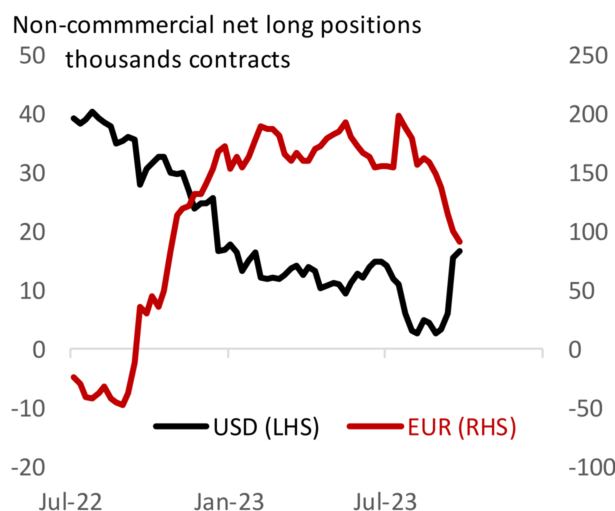
Date	Monetary policy bias		
	Pause	Near peak	Hike
Mon, 2 Oct	Harker	Powell Williams	Mester
Tue, 3 Oct	Bostic		
Wed, 4 Oct	Goolsbee		Bowman
Thu, 5 Oct		Daly Barr	Mester
Fri, 6 Oct			Waller

Sources: DBS Research, Bloomberg

Most of this week's Fed speakers, including Fed Chair Jerome Powell today, share New York Fed President John Williams's **view that the Fed was at or near the peak level of interest rates**. Fed officials want rates to stay restrictive for some time to bring inflation back to its 2% target. With other Developed Market central banks holding similar stances, the Fed has the highest policy rate in nominal and real terms.

Hence, we **see DXY underpinned against its components**. DXY closed above 106 for the first week since last November. According to the US Commodity Futures Trading Commission (CFTC), speculators amassed the largest net long USD positions since early March and the least net long EUR positions since October. This week, **European Central Bank officials should push for its first pause** at the governing council meeting **on 26 October**. Eurozone's CPI estimate fell faster than expected to 4.3% YoY in September vs. the consensus for a decline to 4.5% from 5.2% in August. In early September, the European Commission predicted Germany's recession would be worse at -0.4% vs. its previous -0.2% forecast in June.

Speculators favouring USD over EUR



Sources: DBS Research, CFTC COT data on Bloomberg

USD/CHF has an upside bias between 0.9060 and 0.9440, its range in 1Q23. Tomorrow, Switzerland's CPI and core inflation should stay inside its 0-2% target for a fourth consecutive month into September. The Swiss National Bank paused for the first time on 21 September in anticipation of subdued economic growth over the next few quarters. The State Secretariat for Economic Affairs (SECO) forecasts growth languishing at 1.1% in 2023 and 1.2% in 2024, below its long-term average of 1.7% from a strong CHF and weaker global demand, especially in Europe, hurting its export-driven economy.

Philip Wee

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Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations)

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