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Macro Insights Weekly

A welcome dollar correction

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- *As markets have finally settled on the notion of the Fed tightening cycle peaking and likely rate cuts in 2H24, a period of USD weakness is likely in the making, in our view.*
- *Speculators with short position on the USD got it wrong earlier this year.*
- *Fed narrative of "higher for longer" in fact caused a dollar rebound in late summer.*
- *But now, with inflation and growth cooling, we think there is room for USD weakness.*
- *The key source of correction would likely be JPY, which we estimate as highly undervalued.*
- *For EMs, USD softening would provide relief to a wide range of hard currency borrowers.*

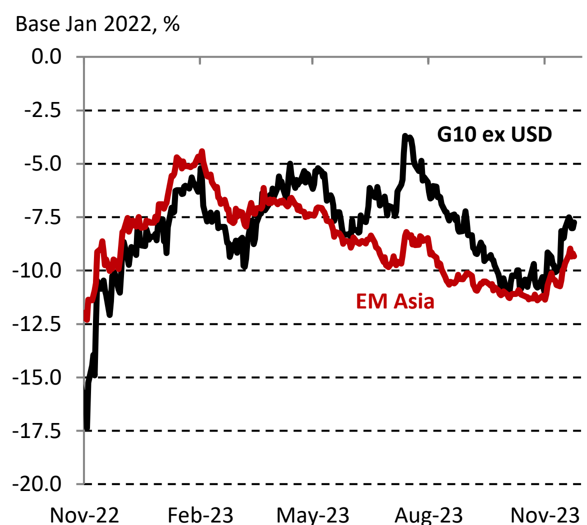
Key data release and events this week:

- *We expect the BOT and BOK to keep policy rates steady.*
- *China's manufacturing PMI likely improved marginally in Nov.*
- *India's 2QFY24 growth stayed strong at 6.7% YoY.*

Chart of the Week: Respite from soaring USD

The dollar has been volatile over the past year. But after changing its mind several times about the end of US policy rate cycle, the markets appear to have settled on no further hikes, and likely cuts in 2H24. This recent development has acted as a palliative to the global currency markets, and both EM and DM currencies have rallied against the dollar in recent weeks. The weakness comes as a welcome respite, as hard currency debt markets have been battered by soaring dollar and rates

Currency Returns - EM Asia vs DM



Source: Bloomberg, DBS

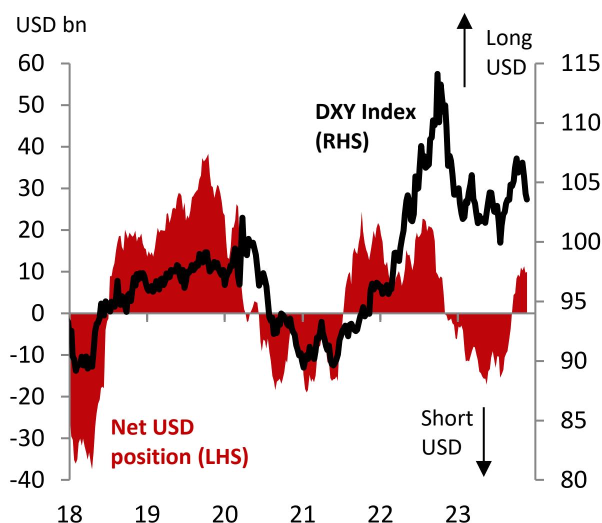
Refer to important disclosures at the end of this report.

Commentary: A welcome dollar correction

Fed rate hikes that began in early 2022 opened up large interest differentials in favour of the USD against most currencies worldwide. Against the ECB's monetary policy normalisation cycle, the US central bank's overnight target rate commands a 100bps spread presently, while the gap with BoJ's policy rate is over 550bps. Little wonder that through most of 2022, global markets capitulated to a strong dollar.

But that course was supposed to reach its end in the first half of this year. Under the burden of high rates, the US economy was expected to slow down, and the Fed was expected to respond to such adverse outcome with rate cuts. In the event though, the economy did not lose momentum, the decline in inflation took longer than expected, and with exception of some hiccup in regional banks back in March, overall financial sector stability was sound. Currency speculators who had taken short positions on expectations of a peak of the rates cycle and eventual USD correction got it largely wrong in the first three quarters of 2023.

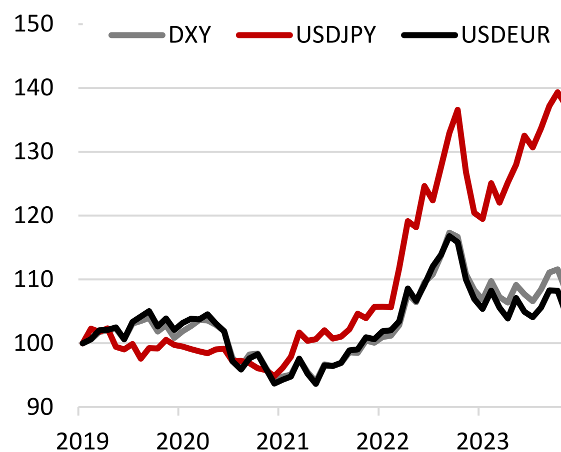
Speculative positioning on USD



Source: Bloomberg, DBS

DXY, the dollar index, after correcting in late 2022, remained largely range bound for most of this year, but then underwent a surprise uptrend in September/October as the market fretted again about the Fed's "higher for longer" narrative. Favourable inflation prints and some signs of cooling growth have stabilised sentiments lately, with the dollar correcting a tad in recent weeks. We think this has the makings of a sustained correction.

DXY and key drivers



Source: Bloomberg, DBS. All FX rates set at January 2019=100

Unlike earlier episodes this year, we now subscribe to the notion of the Fed cycle peaking amid economic softening. The dollar, in our view, therefore has room to correct further, with the only major spoiler in the near term being geopolitical risks.

The biggest source of correction would likely come from the Japanese yen, which is considerably undervalued and has BoJ's policy normalisation as a pipeline driver. For emerging market economies, some softening of the greenback would be welcome, providing relief to hard currency borrowers, both sovereigns and corporates. This is a positive development going into 2024.

Taimur Baig

Key forecasts for the week

Event	DBS	Previous
Nov 27 (Mon)		
Hong Kong: exports (Oct)	-5.1% y/y	-5.3% y/y
- imports	-0.4% y/y	-0.4% y/y
- trade balance	HKD64.6bn	HKD64.6bn
Nov 29 (Wed)		
Thailand: BOT benchmark rate	2.50%	2.50%
Vietnam: exports (Nov)	13.0% y/y	5.9% y/y
- imports	6.0% y/y	5.2% y/y
- trade balance	USD2.9bn	USD3.0bn
- Retail sales YoY YTD	9.4% y/y	9.4% y/y
- CPI	3.2% y/y	3.6% y/y
Nov 30 (Thu)		
China: manufacturing PMI (Nov)	49.8	49.5
Hong Kong: retail sales value (Oct)	12.5% y/y	13.0% y/y
India: GDP (3Q23)	6.7% y/y	7.8% y/y
South Korea: BOK 7-day repo rate	3.50%	3.50%
South Korea: industrial production (Oct)	5.7% y/y	3.0% y/y
Japan: industrial production (Oct)	0.2% m/m sa	0.2% m/m sa
Dec 1 (Fri)		
Indonesia: CPI (Nov)	2.6% y/y	2.6% y/y
South Korea: exports (Nov)	3.0% y/y	5.1% y/y
- imports	-12.8% y/y	-9.7% y/y
- trade balance	USD2.0bn	USD1.6bn

Central bank policy meetings

Bank of Thailand (BOT) (Nov 29): We expect the BOT to maintain its policy rate at 2.50% during its final meeting of the year. Policymakers are likely to adopt a wait-and-see approach, after mentioning that the policy rate was ‘appropriate’ during its Sep decision. While growth and inflation have moved down, and the BOT looks likely to lower its forecasts, policymakers will probably assess that the recovery is still intact, while inflation is partly curbed by government policies.

Reserve Bank of New Zealand (RBNZ) (Nov 29): We expect the RBNZ to keep the official cash rate unchanged at 5.50% for the fourth straight meeting. CPI inflation slowed to 5.6% YoY in 3Q23 from 6% in 2Q23. More importantly, an RBNZ quarterly survey in 4Q23 reported 1Y inflation expectations declining to 3.6% vs. 4.2% three months earlier, closer to the RBNZ’s 1-3% inflation target range. The newly formed coalition government led by the National Party will amend the RBNZ Act 2021 to end the dual mandate and to focus monetary policy solely on inflation.

Bank of Korea (Nov 30): We expect the Bank of Korea to maintain the policy rate at 3.50% and uphold a hawkish bias. The BOK is anticipated to stay vigilant regarding inflation risks and the expansion of household debt. As of October, headline CPI remained high at 3.8% YoY. Meanwhile, mortgage loans from banks to the household sector rebounded to 5.6%. Despite these factors, the BOK is unlikely to take any actions to raise rates. Core CPI is still following a gradual easing trajectory, slowing to 3.2% in October. Corporate financing conditions remained weak, evident in the deceleration of corporate loans and corporate bond issuance. Additionally, the KRW has recently regained lost ground, attributed to the decline in UST yields and the easing of capital outflow pressures. This development is expected to alleviate the BOK's concerns about imported inflation caused by prolonged weakness of the KRW.

Forthcoming data releases

China: The Manufacturing PMI is projected to show marginal improvement from October's 49.5 to 49.8, albeit staying in the contraction zone. High frequency data such as electric furnace utilisation rate and asphalt plant operating rate have seen slight improvement from previous month. However, external and domestic demand remained muted. On the external front, the global economy is cooling due to elevated interest rates, and the acceleration of supply-chain relocation is adversely affecting the production of medical goods and labour-intensive products. Domestically, production demand was dragged by the subdued property sector. Real estate

related commodity output such as cement, glasses, iron and steel contracted by 1-4% YoY in October.

Hong Kong SAR: Contraction of exports is expected to narrow from 5.3% YoY in Sep to 5.1% in Oct, predominantly due to an extended low-base effect. External demand from Mainland China and the rest of the world are hampered by high interest rates. Likewise, imports should have contracted by 0.4% YoY as domestic demand remained tepid. Retail sales growth is expected to ease further from 13.0% YoY to 12.5% YoY. The strong Hong Kong dollar is limiting the spending ability of tourists and encouraging people to travel abroad. the weakened asset markets are negatively impacting the consumption confidence through negative wealth effect.

South Korea: November trade data will be released this week, with exports poised to maintain single-digit growth for the second consecutive month, at 3.0% YoY. Preliminary data has unveiled a 3.2% export growth in the first 10 days of November and 2.2% in the first 20 days. A significant contributing factor is the clearance of electronics and semiconductor inventories in the global market. Semiconductor exports are expected to demonstrate positive YoY growth in November, marking the first such occurrence since mid-2022.

Vietnam: Nov 2023's data will likely see a further improvement in Vietnam's exports, steady retail sales, and a pullback in inflation. We expect Vietnam's exports to rise for the third straight month by 13.0% YoY, supported by increasingly favourable base effects, and ongoing improvements in electronics shipments, notwithstanding a still challenging global economic environment. Retail sales were likely supported by a still resilient labour market.

Headline inflation likely retreated to 3.2% YoY in Nov, from Sep's and Oct's 3.6-3.7% YoY, in our view. This was likely due to falling domestic retail oil prices, which declined in MoM terms for the second straight month in Nov, and a slight moderation in core inflation, despite a modest uptick in food inflation.

India: India is due to release its 3Q23 (2QFY24) growth numbers this week. Factoring in our GDP Nowcast model's readings, we expect real GDP growth to have risen 6.7% YoY, higher than the RBI's forecast. Service sector activity likely stayed buoyant in 2Q, besides manufacturing growth, as signalled by stronger high-frequency prints including PMIs, capacity utilisation, credit growth, infrastructure indices etc. Our consolidated consumption proxy index suggests that urban demand fared better than rural spending in the period, with the deceleration in inflation towards late in the quarter likely providing relief to purchasing power. Construction likely sustained momentum with fluctuations in the southwest monsoon causing less disruption than in the past. This was accompanied by a 26% YoY lift in the centre's capex expenditure in the period.

Economics Team

FX: Fed and the ECB's narrow policy gap

DXY depreciated by 0.5% to 103.4, modestly below the 103.52 level at the end of 2022. **Markets should be leaning against the greenback into** Thursday's US **PCE deflator data** mirroring the slowdown in CPI inflation a fortnight ago. Economists polled by Bloomberg expect headline inflation to decline to 3.1% YoY (0.1% MoM) in October from 3.4% YoY (0.4% MoM) in September and core inflation to 3.5% YoY (0.3% MoM) vs. 3.7% YoY (0.2% MoM).

Markets may cover their short USD positions into Fed Chair Jerome Powell's fireside chat on Friday. Powell will not declare victory because of the resilience of the US economy. On 29 November, the Bureau of Economic Analysis will likely revise 3Q23 GDP growth to 5% QoQ saar from its advance estimate of 4.9%. Given the recent rebound in US equities on a retreat in the US long bond yields, the Conference Board's consumer confidence index could surprise tomorrow. Pay attention to Thursday's initial jobless claims for signs of resilience in the US labour market. Last week, claims surprised with a decline to 209k in the week ending 18 November; consensus had expected a shallower fall to 227k from 233k a week ago.

Powell should push back against the market's rate cut bets by maintaining the need for "higher for longer rates" to return inflation to its 2% target promptly. The Fed will get more information from the monthly jobs report on 8 December and November's CPI data on 12 December before deciding whether to deliver the hike pencilled in September's Summary of Economic Projections at the FOMC meeting on 13 December.

EUR/USD is hesitant near the 1.10 resistance level and has languished between 1.0852 and 1.0965 the past fortnight. Today, European Central Bank President Christine Lagarde will likely tell the EU Parliament that the ECB could afford to pause its hiking cycle to observe the impact of past hikes on the stagnant Eurozone economy. Lagarde should also urge EU leaders to agree on their fiscal rules by the end of 2023, adding that the ECB needed clarity on the direction of fiscal policy in setting monetary policy. The ECB warned that the Eurozone banks were exhibiting early signs of stress from a squeeze on their profits from higher funding costs, a drop in lending volumes, a rise in loan defaults, and late repayments.

The ECB paused for the first time on 26 October after the real refi rate turned positive in September from the refi rate falling 450 bps to 4.50% from July 2022 to September 2023, and CPI inflation falling to 2.9% YoY in October vs. its 10.6% peak a year earlier. On Thursday, consensus expects CPI estimate to drop to 2.7% YoY in November from 2.9% in October and core inflation to decline to 3.9% from 4.2%. The ECB should pause again at its governing council meeting on 14 December. However, **Lagarde was also keen to push back rate cut bets**. She warned a fortnight ago that inflation could rise in the coming months on base effects and saw inflation back at the 2% target only in late 2025. Lagarde hinted that keeping rates high "long enough" meant no policy actions in the "next couple of quarters."

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