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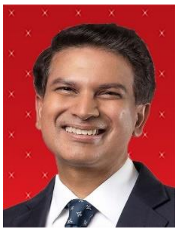
# Macro Insights Weekly

## USD strength and Asian FX: Manageable risks

**Group Research**

**October 30, 2023**

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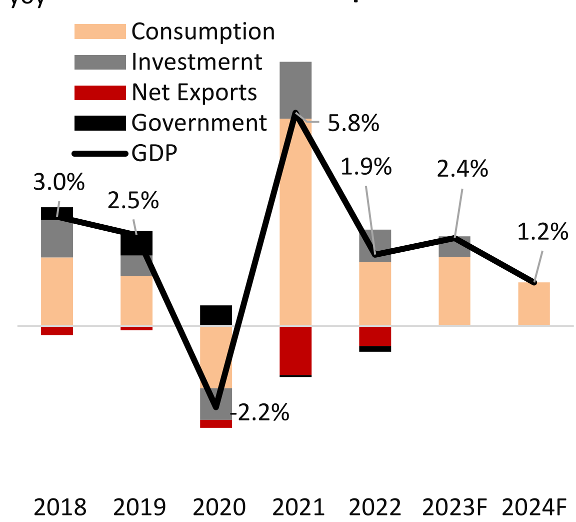
- *The high-for-long narrative for US rates has taken hold in the last three months, manifesting in a rebounding USD, and by extension, weakness in some Asian currencies. But risks are manageable.*
- *Currency weakness poses a couple of headaches at this phase of the cycle.*
- *Inflation passthrough is one; external funding stability is the other.*
- *BI and BSP's rate hikes this month reflect attention to both factors.*
- *We don't see contagion or overshoots in the region.*
- *Asian FX may face some pressure, they have much sounder fundamentals than their peers elsewhere.*

**Key data release and events this week**:

- *The Fed and BOJ are expected to keep the respective policy rates unchanged.*
- *GDP growth of both Eurozone and Taiwan are expected to ease slightly.*
- *Pick-up in HK's GDP growth is largely due to low-base effect.*

### Chart of the Week: US GDP running hot

Driven by a 4% rise in consumption, US real GDP grew by 4.9% (qoq, saar) in Q3. Inventories and public spending added to GDP, while private investment and net exports subtracted. Incorporating the data release, we are pushing up the 2023 real GDP growth forecast to 2.4% (from 2%). We are comfortable with our 2024 growth forecast of 1.2%, as consumption would slow under the burden of 5%+ interest rates. Q3 figures represent the US economy at its hottest; quick cooling is in the making, in our view.




Source: CEIC, DBS

## Commentary: USD strength and Asian FX: Manageable risks

2023 was going to be year when the dollar peaked and EM currencies breathed a sigh of relief from interest rates and commodity prices topping out. That scenario largely panned out from the beginning of the year to July, during which period the DXY index depreciated by about 5%. But since then, the high-for-long narrative has set in, and the markets have priced out much of the rate cuts expected next year. This has in turn buoyed the USD, with the DXY rebounding by 6.5% in three months.

This development has taken place at a time of a broadly unfavourable backdrop for EM. The trade cycle remains lacklustre, commodity prices have begun to grind higher, while geopolitical risks have spiked.

Asian economies have felt the heat, even if their fundamentals are mostly sounder than their peers in LatAm, EMEA, and MENA, as per our country risk analysis exercise (link). After displaying a fair degree of stability during most of the year, several Asian currencies have faced selling pressure over the last three months. Malaysian Ringgit, Korean Won, Thai Baht, and Chinese Renminbi have all depreciated ytd by 6% or more.

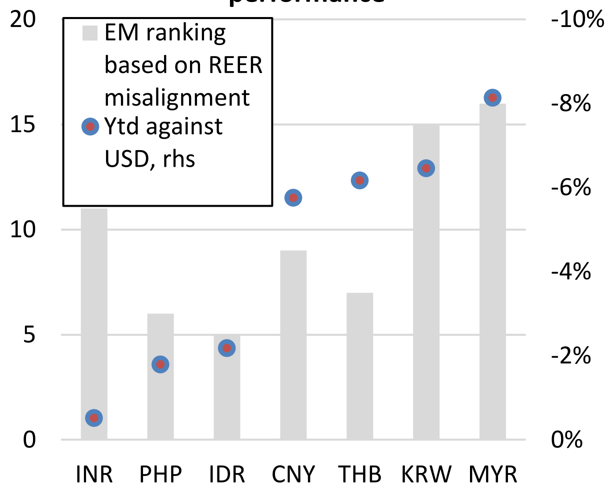
The weakening currencies pose a headache to regional central bankers, PBOC being one exception. Risk of inflation passthrough is the key concern, but overall financial stability needs to be taken into consideration too. Hard currency borrowing and refinancing have already dried out as dollar rates have soared; a bout of currency weakness makes a difficult situation worse.  This explains why the central banks of Indonesia and the Philippines have undertaken surprise rate hikes this month.

Our FX analytics offer useful ways to put the Asian currency market stress in perspective. In our country risk analysis exercise, we assess and rank a range of fundamental variables including fiscal balance, government debt, international reserves, external funding needs, and real exchange rate (REER).

We obtain the REER ranking by simply taking, for each currency, their deviation from 10-year average REER. A ranking is then made, based on the absolute value of the trend deviation of the 25 currencies in the study.

The ranking of Asian currencies, based on end-2022 data, correlate well with their 2023 performance. The four Asian currencies that rank the lowest in our sample have had the four largest bouts of depreciation in the region this year. An exception is the Indian rupee, which has held firm despite coming into 2023 with room for correction. Our tactical view is that this opens up a long USD, short INR trade.

**Currency misalignment and performance**




Source: CEIC, DBS

*Taimur Baig*

## Key forecasts for the week

| Event | DBS | Previous |
|---|---|---|
| **Oct 30 (Mon)** | | |
| Eurozone: GDP (3Q A) sa | 0.2% y/y | 0.5% y/y |
| Eurozone: CPI (Oct) | 3.4% y/y | 4.3% y/y |
| **Oct 31 (Tue)** | | |
| BOJ policy balance rate | -0.1% | -0.1% |
| BOJ 10Y yield target | 0% | 0% |
| Japan: industrial production (Sep) | 1.0% m/m sa | -0.7% m/m sa |
| China: manufacturing PMI (Oct) | 50.2 | 50.2 |
| Hong Kong: GDP (3Q A) | 5.2% y/y | 1.5% y/y |
| Taiwan: GDP (3Q A) | 1.2% y/y | 1.36% y/y |
| South Korea: industrial production (Sep) | -2.5% mm sa | 5.5% m/m sa |
| **Nov 1 (Wed)** | | |
| Hong Kong: retail sales value (Sep) | 12.0% y/y | 13.7% y/y |
| Indonesia: CPI (Oct) | 2.6% y/y | 2.28% y/y |
| **Nov 2 (Thu)** | | |
| FOMC rate decision | 5.50% | 5.50% |
| South Korea: exports (Oct) | 6.3% y/y | -4.4% y/y |
| - imports | -5.5% y/y | -16.5% y/y |
| - trade balance | -$142mn | $3697mn |
| South Korea: CPI (Oct) | 3.6% y/y | 3.7% y/y |
| Malaysia: BNM overnight rate | 3.00% | 3.00% |

## Central bank policy meetings

**Bank of Japan (Oct 31):** Further adjustments to the BOJ's YCC policy framework are possible but not highly probable at the upcoming meeting. Potential options include widening the 10Y yield band, raising the rate for fixed-rate operations, and reinforcing the fixed-rate operations while eliminating the 10Y yield reference rate. But market pressure for immediate changes is not particularly compelling. Also note that the BOJ recently took actions in July by revising the rate for fixed-rate operations to 1%. Implementing sequential changes within three months could raise expectations for additional adjustments, potentially resulting in undesired market impacts. The likelihood of the BOJ terminating YCC or NIRP at the upcoming meeting is low. Policymakers would prefer to wait for the 2024 Shunto results and, importantly, to witness significant improvements in macro wage data to ensure the success of their reflation efforts.

**Bank Negara Malaysia (BNM) (Nov 2):** We think that BNM will be inclined to maintain its overnight policy rate (OPR) at 3.00% during its final meeting for 2023. Malaysia's inflation is contained, cooling to 1.9% YoY in Sep 2023, the lowest since early-2021, despite upside risks in 2024 from a shift to targeted subsidies and services tax hike. Meanwhile, growth remains soft at just 3.3% YoY in 3Q23, based on advance GDP numbers, amid a still uncertain global economic environment. BNM, therefore, likely has little urgency to resume rate hikes. However, currency weakness is a key risk. The Malaysian ringgit has weakened to an all-time low vs the US dollar, depreciating by ~8% year-to-date in 2023. This is also set within the context of the restart of hikes by ASEAN central banks such as Bank Indonesia to ensure currency stability. On October 23, BNM Governor acknowledged the MYR weakness, and stressed that the central bank 'remains committed to deploy necessary measures' to ensure orderly ringgit adjustment. Adding that the MYR movements were heavily influenced by global events, and do not reflect Malaysia's economic fundamentals, he also said that BNM can be in the market when needed. This suggests that BNM might be skewed towards market intervention measures, rather than hiking interest rates to marginally reduce the interest rate gap with the US.

**Bank of England (BOE) (2 Nov):** The BOE is predicted to uphold the bank rate at 5.25%, mirroring its previous stance. Notably, it may echo the European Central Bank's caution regarding impending economic softness for the year's remainder. Despite inflation lingering above the 2% target, UK payrolls contracted for the third month in September. The IMF has forecast the UK economy as the worst in G7 in the coming year. Prime Minister Rishi Sunak is leaning towards tax reductions preceding the January 2025 elections, while Chancellor

Jeremy Hunt faces Tory MPs' pressure to announce tax cuts in his November 22 Autumn Statement. However, fiscal finances are constrained by record-high borrowing costs and a soaring government debt above 100% of GDP. Hence, a pivot from the BOE away from rate hikes towards a prolonged "sufficiently restrictive" monetary policy is foreseeable.

**Forthcoming data releases**

**South Korea:** Exports are expected to return to positive growth in October, putting an end to a year-long contraction, primarily driven by inventory clearance in the electronics sector. However, trade balance will likely shift back into a modest deficit due to the increase in global oil prices, triggered by the Middle East crisis. On the other hand, CPI inflation is projected to show only a mild easing, coming in at 3.6% YoY in October, compared to 3.7% in September. While food prices are expected to stabilize following the Chuseok festival, the increase in oil prices continues to pose upside risks to inflation. Given the latest trends in growth and inflation, we have revised our expectations for the timing of a BOK rate cut to 2Q 2024.

**Taiwan:** GDP growth is projected to remain stable at 1.2% YoY in 3Q. Exports have rebounded into positive territory, primarily driven by increased demand for electronics. However, investment continues to experience significant contraction, reflecting capacity utilization levels below normal. Notably, consumption growth has decelerated due to the waning effects of stimulus measures and reduced reopening demand. Inventory destocking is an additional factor dragging GDP performance. We expect stronger recovery momentum from 4Q onwards, with GDP growth projected to reach the 3% level in 2024.

**China:** Manufacturing PMI is expected to stay in expansion zone at 50.2 in October as economic activities continued to stabilize. Demand from both retail and infrastructure are accelerating. Domestic tourism revenue and traffic during week-long National Day Holiday has already outpaced the pre-COVID level. Meanwhile, infrastructure investments have been growing faster than the headline figures. Recent approval of the RMB1trn sovereign bond will boost the related spending and stimulate industrial production ahead. Likewise, external demand appeared to be more resilient than expected. The demand from US and Japan are expected to offset shortfall from Europe.

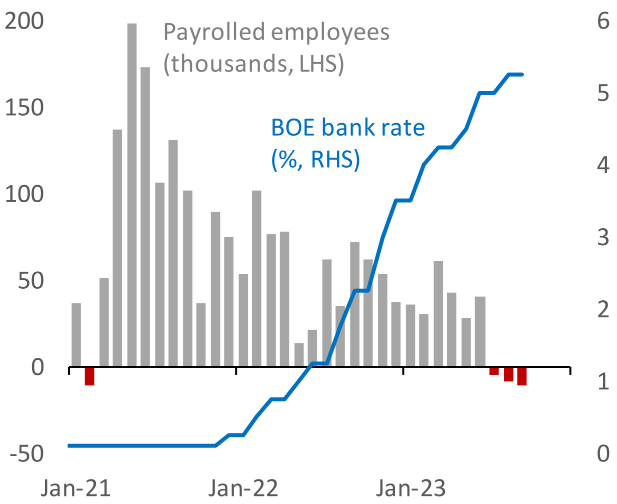
**Hong Kong SAR:** GDP growth is expected to accelerate from 1.5% YoY in 2Q to 5.2% in 3Q due to low-base effect. The recovery was restrained by the elevated interest rates. On consumption front, retail sales growth is expected to ease further from 13.7% YoY to 12.0% YoY. Strong HKD alongside is curbing the spending power of tourist and motivating outbound tourism. Weak asset markets are adversely affecting the consumption sentiment through negative wealth effect. External demand from Mainland China and the rest of the world will continue to be hampered by high interest rates. The end of year-long exports and imports contractions was predominantly due to an extended low-base effect. While demand from Mainland China appeared to stabilize, a sustainable recovery will require PBOC rate cuts, and the magnitude is conditional on the Fed. Meanwhile, both CAPEX and real estate investment were sluggish amid high rates.

*Economics Team*

## FX: Monetary policy crossroads

**This week's FOMC meeting is anticipated to retain the DXY within its established range of 105.3 to 107.4** over the last month, despite market predictions of the Fed maintaining the Federal Funds Rate at 5.25-5.50%. The Atlanta Fed's GDPNow model projects a deceleration in US GDP growth to 2.3% QoQ saar in 4Q23, following a surge to 4.9% in 3Q23. This outlook is justified should tomorrow's consumer confidence index decline to 100 this October from 103. The consensus for Friday's non-farm payrolls is a drop to 190k in October from 336k in September. However, the narrative could shift if Fed Chairman Jerome Powell assumes a hawkish tone at his press conference, fuelled by a streak of robust US economic data. Such a stance could bolster the US 10Y bond yield and the DXY, hinting at a potential rate hike as outlined in the September dot plot.

**UK payrolls negative for a third month**




Sources: DBS Research, Bloomberg data

**GBP/USD might retest the 1.2037 mark**, its October 4 low, **within the week.** The Bank of England is predicted to uphold the bank rate at 5.25% on 2 November, mirroring its previous stance. Notably, it may echo the European Central Bank's caution regarding impending economic softness for the year's remainder. Despite inflation lingering above the 2% target, UK payrolls contracted for the third month in September. The IMF has forecast the UK economy as the worst in G7 in the coming year. Prime Minister Rishi Sunak is leaning towards tax reductions preceding the January 2025 elections, while Chancellor Jeremy Hunt faces Tory MPs' pressure to announce tax cuts in his November 22 Autumn Statement. However, fiscal finances are constrained by record-high borrowing costs and a soaring government debt above 100% of GDP. Hence, a pivot from the BOE away from rate hikes towards a prolonged "sufficiently restrictive" monetary policy is foreseeable. Per the Commitment of Traders Report, speculative positions shifted to net short GBP early October, following a negative reversion in the UK-US 10-year bond yield spread in mid-September.

**USD/JPY faltered in its attempt to breach the 150 level last week.** The market remains sceptical towards any policy adjustments from the Bank of Japan concerning its yield curve control framework or negative interest rate policy in the upcoming 31 October meeting. Yet, it hasn't entirely dismissed potential surprises. Post the YCC policy tweak in July, the 10Y JGB yield rose past 0.50% to nearly 0.90%. A recent Reuters poll (17-25 October) revealed a majority, 63%, anticipate the BOJ to phase out the NIRP by end-2024, with the remainder eyeing 2025. In a bid to spur domestic spending, Rengo, Japan's largest labour union, is set to propose over a 5% wage hike in 2024, a jump from this year's 3% increment.

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