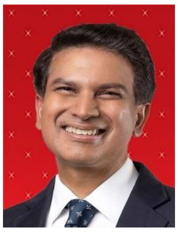
Macro Insights Weekly

Implications of the strong US labour market

Group Research April 8, 2024



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- *The US economy continues to chug away at above-trend growth rate, pulling up the labour market with it. This may slow down disinflation, but that would be a constructive backdrop.*
- *The impressive jobs numbers reveal momentum in the services and public sectors.*
- *Consumers, shocked by 2022 inflation spike, have belatedly begun to feel better.*
- *We see gathering upside to GDP growth, revising up our 2024 forecast by 30bps to 2%.*
- *Strong jobs and incomes may slow down the path of disinflation.*
- *But a sharp rebound in inflation is unlikely, given the spate of supply side reforms underway.*

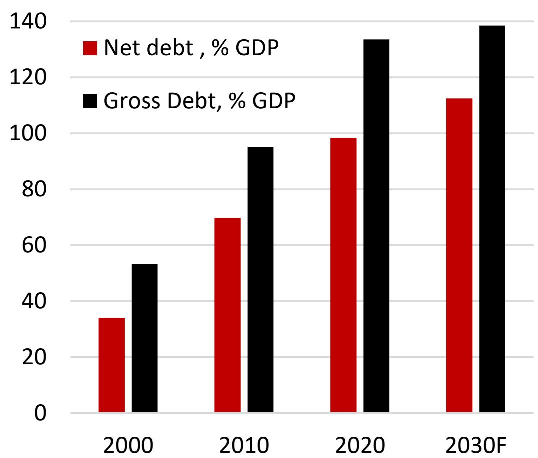
Key data release and events this week:

- *Singapore's 1Q24 real GDP expected to grow steadily at 2.3% YoY.*
- *Bank of Thailand to reduce policy rate by 25bps to 2.25%.*
- *Exports of China and Taiwan should have improved due to fading seasonal effect.*

Chart of the Week: US fiscal path

Current macroeconomic sweet spot notwithstanding, US fiscal trajectory is worrisome. Burdened by major public outlays in defence, healthcare, pension, and infrastructure, and thrown off-course by the pandemic, public debt more than doubled during 2000-20. With little by way of new revenue measures, the outlook for this decade is unfavourable. Annual deficits amounting to over 5% of GDP are on the cards, with interest payments likely to exceed 3% of GDP.

US general govt debt path, 2000-2030

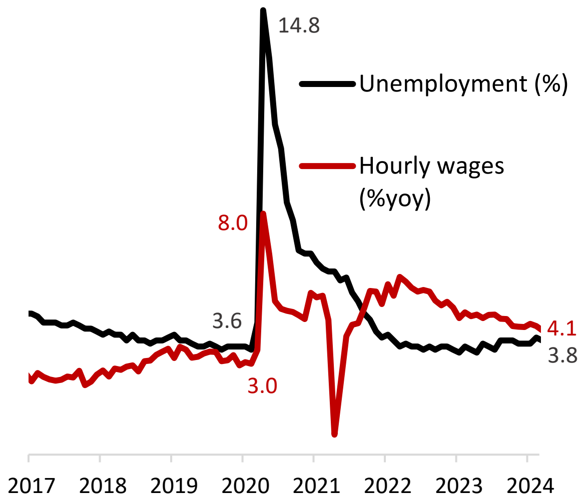


Source: IMF FIscal Monitor 2023, DBS

Commentary: Implications of the strong US labour market

Withstanding two years of monetary policy tightening, the US economy continues to chug away at above-trend growth rate, pulling up the labour market with it. The statistics are impressive across a wide range of measures. Unemployment is below 4%, weekly initial claims for unemployment insurance has been near historical lows for over two years, and the labour force participation rate is on the rise after a few years of pandemic-driven dip. Labour market would have been even tighter had it not been for the fact that immigration has picked up, boosting the supply of workers.

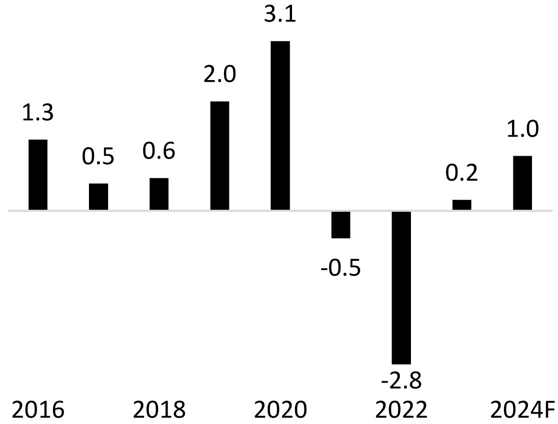
Labour market



Source: CEIC, DBS. Data through March 2024

Strong demand for workers has translated into healthy wage growth. We estimate that real wage growth to be positive in both 2023 and 2024, implying purchasing power getting restored after the setback caused by the inflation spurt in 2022. Consumers, shellshocked by that episode, have taken their time to recognise the improving economic landscape, but they are catching up. University of Michigan's US index of consumer confidence has been trending up, reaching a two-and-half year high in March.

US real wage growth, %yoy

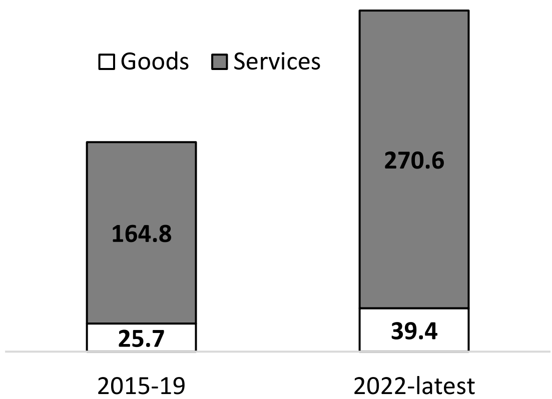


Source: CEIC, DBS. Real wage calculated by taking the difference between annual average nominal hourly wage growth and average CPI inflation.

One way to look at labour market strength is to see it as part of post-pandemic normalisation. But this cycle is anything but "normal." Since 2022, the labour market recovery has been not just vigorous, its composition atypical. In nonfarm payrolls, for instance, service sector jobs growth has been much more robust than the goods sector. Even more striking is the role of public sector in jobs creation. While private sector employment has expanded impressively, its growth rate pales in comparison to government jobs, which have been growing at three times the pre-pandemic period.

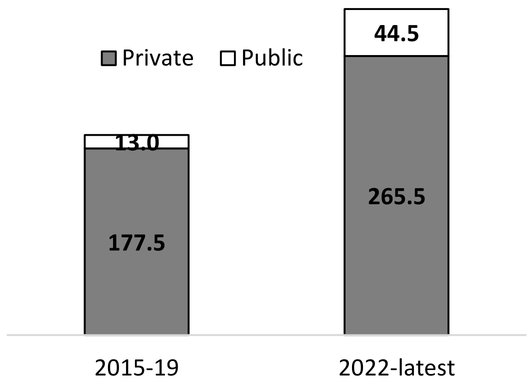
US non-farm payrolls

Average monthy change, sa, thousands



Source: CEIC, DBS

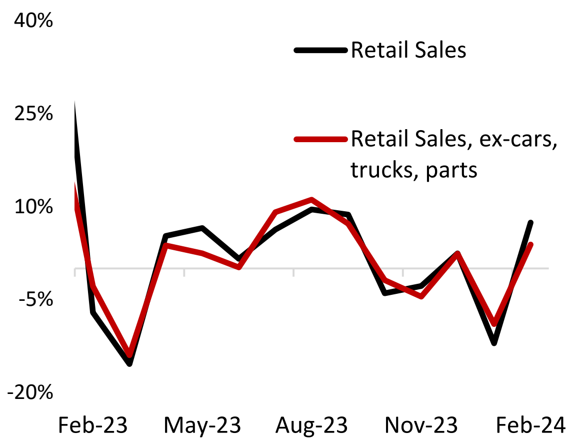
US non-farm payrolls
Average monthy change, sa, thousands



Source: CEIC, DBS

The data underscore the pronounced role of the public sector in this cycle. From record cash transfer to the population during the lockdown to multi-trillion dollar infrastructure programmes, this cycle has been supported by public sector outlays like never before.

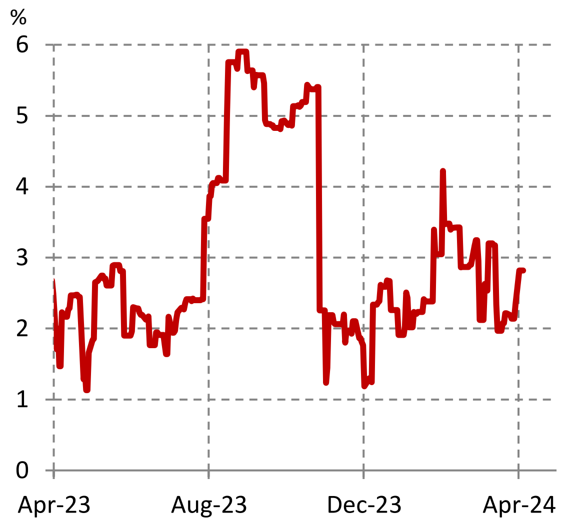
Retail sales



Source: CEIC, DBS. Monthly data are seasonally adj; m-o-m change is calculated and annualised.

From strong retail sales to the run-up in equity prices, the outlook has strong underpinnings. Consumers are optimistic about job and income prospects, they have enjoyed substantial capital gains on their portfolios of stocks and homes, and their savings are receiving positive real returns. Taking these into account, we have revised up our 2024 GDP growth forecast to 2%, while recognising additional upside to the forecast if financial markets remain stable the rest of the year.

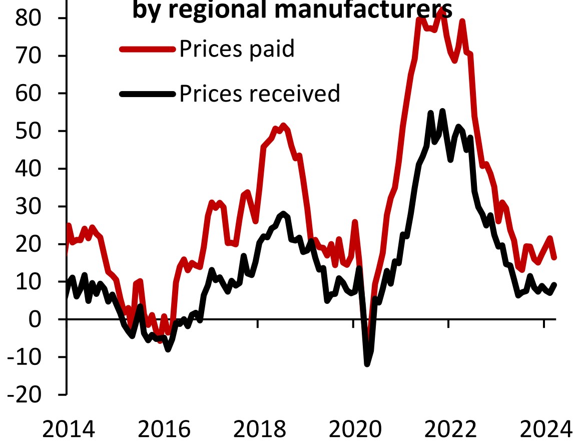
US GDP Nowcast (Atlanta Fed)



Source: Bloomberg, DBS

Could the buoyant labour market spill over into inflation risks? We think there is a difference between inflation turning sticky, which may be happening right now, and rebounding substantially, which we think is unlikely. Headline inflation may not ease much further as commodities bottom, but an economy with growth in jobs and infrastructure should be a stable one. There might even be room for some rate cuts eventually.

Fed Survey: Prices paid and received by regional manufacturers



Soure: CEIC, DBS. Note: Average of prices paid and received in surveys conducted by New York, Kansas City and Philadelphia Fed district banks.

Taimur Baig

Key forecasts for the week

Event	DBS	Previous
Apr 8 (Mon)		
Malaysia: Industrial production (Feb)	-1.5% y/y	4.3% y/y
Philippines: BSP o/n rate	6.50%	6.50%
Apr 9 (Tue)		
China: M1 (Mar)	1.5% y/y	1.2% y/y
China: M2 (Mar)	8.4% y/y	8.7% y/y
China: Aggregate Financing (Mar)	RMB2,592bn	RMB6,536bn
China: New Yuan Loans (Mar)	RMB2,122bn	RMB4,914bn
Taiwan: CPI (Mar)	2.1% y/y	3.1% y/y
Apr 10 (Wed)		
Thailand: BOT benchmark rate	2.25%	2.50%
Taiwan: exports (Mar)	10.3% y/y	1.3% y/y
- imports	0% y/y	-17.8% y/y
- trade balance	USD7.9bn	USD7.9bn
US: CPI (Mar)		3.2% y/y
Apr 11 (Thu)		
Eurozone: ECB refinancing rate	4.50%	4.50%
China: CPI (Mar)	0.9% y/y	0.7% y/y
China: PPI (Mar)	-2.0% y/y	-2.7% y/y
Philippines: exports (Feb)	7.8% y/y	9.1% y/y
- imports	3.2% y/y	-7.6% y/y
- trade balance	-USD4.0bn	-USD4.2bn
Apr 12 (Fri)		
China: exports (Mar)	6.0% y/y	5.6% y/y
- imports	4.1% y/y	-8.2% y/y
- trade balance	RMB541bn	RMB282bn
India: CPI (Mar)	4.9% y/y	5.1% y/y
- Industrial production (Feb)	6% y/y	3.8% y/y
South Korea: BOK Base Rate	3.50%	3.50%
Singapore: GDP (1Q, A)	2.3% y/y	2.2% y/y
Singapore: MAS MPS	No change	No change

Central bank meetings

Monetary Authority of Singapore (MAS) policy preview (12 April): We expect the MAS to keep unchanged the three parameters of the SGD NEER policy band at the April policy review. Please see Singapore chartbook: Steady MAS policy in April's review for more details. 1Q24 advance GDP estimates will be released alongside the MAS's policy decision. We see 1Q24 real GDP pulling back sequentially by -0.3% QoQ sa, but with steady 2.3% YoY expansion, partly supported by favourable base effects (vs 4Q23's 2.2% YoY, 1.2% QoQ sa). Beyond base effects, YoY growth support likely came from external-led sectors such as manufacturing and trade-related services, alongside tourism-linked segments such as accommodation and food & services that benefitted from the uptick in foreign arrivals and concerts. Construction likely stayed supportive amid the robust project pipeline in both the public and private segments.

Bank of Thailand (BOT) (10 April): The BOT will reassess the neutral interest rate during its upcoming meeting, with the market split as to whether the policy rate will be cut. Our base case is for the BOT to reduce its policy rate by 25bps to 2.25%. The door for rate cuts has opened after the first split decision since 2022 during the previous February 2024 decision. Pressure to reduce rates to support the economy is also mounting amid continued sluggish economic performance in early-2024 (see *'Thailand: Soft economy prompts rethink of neutral interest rate'*). Moreover, core inflation stayed below the BOT's headline inflation target range of 1-3% for the ninth straight month and cooled to 0.4% YoY in March 2024. Yet, we reckon that any policy rate cuts are likely to be a mild adjustment to align with a lower neutral rate, and not likely to be an aggressive easing cycle. This is due to the need to balance with financial stability objectives, such as debt accumulation and excessive currency weakness.

Reserve Bank of New Zealand (April 10): We expect the RBNZ to keep the official cash rate unchanged at 5.50%. Looking ahead, RBNZ Governor Adrian Orr said that more normalized interest rates were on the horizon from slowing aggregate demand, less pressure on core inflation, and inflation expectations returning to target. In March, the IMF, in its Article IV review of the New Zealand economy, saw the potential for interest rate cuts later this year due to inflation returning into its 1-3% target band in 3Q24. CPI fell steadily for the fourth quarter to 4.7% yoy in 4Q23 from 7.2% in 4Q22.

The market is now positioning for three rate cuts in August, October, and November.

Bank of Canada (April 10): The BOC will keep the overnight lending rate unchanged at 5% again. At the last meeting on March 6, BOC stated that it was too early to discuss rate cuts despite CPI inflation falling to 2.8% yoy in January into the 1-3% target. Although inflation fell further to 2.8% yoy in February, it remained above 2% or the midpoint target of the BOC's goal. However, a recent BOC business survey showed progress on inflation expectations, which could lead to potential rate cuts later this year. For example, 54% of the respondents predicted inflation in a 2-3% range over the next two years, up from 39% in the previous survey. Additionally, the share of respondents planning larger-than-normal price increases has declined to 17% from 23%. The market will observe this meeting to affirm the three rate cuts expected in July, August, and November.

Bank of Korea (April 12): The Bank of Korea is expected to maintain the policy rate at 3.50% during Friday's meeting. A key factor inhibiting rate reductions is the BOK's uncertainty regarding the timeframe for inflation to reach the 2% target. March's CPI inflation stood at 3.1% YoY, mirroring the 3.0% seen in Jan-Feb, while MoM growth has receded to 0.1% from Jan-Feb's 0.5%. Core CPI has stabilized around 2.5% for the past three months (Jan-Mar). Inferred from the sequential momentum, headline CPI is projected to decline to the mid-2% range in 3Q. As such, policymakers will likely maintain an open stance towards 2H rate cuts during Friday's meeting.

Forthcoming data releases

China: In March, the official PMI returned to expansionary territory for the first time in six months. Exports is anticipated to grow from 5.6% YoY in February to 6.0% in March, with regional electronics exports showing signs of bottoming out. This is evidenced by leapfrogged new export order sub-PMI from 12 months of contraction. The manufacturing PMI of ASEAN also further expanded from 50.4 to 51.5. Imports growth is expected to rebound from -8.2% YoY in February to 4.1% in March, supported by an improvement in the import sub-PMI from 46.4 to 50.4 in March. With business sentiment improving, CPI and PPI are anticipated to gradually increase from 0.7% and -2.7% YoY to 0.9% and -2.0% respectively in March. M1 growth is projected to increase from 1.2% YoY in February to 1.5% in March, while M2 growth is expected to slow from 8.7% YoY in February to 8.4% in March. On loans, we anticipate a normalization in the new increase in aggregate financing from RMB1,521 billion in February to RMB2,592 billion in March, largely due to seasonal factors.

Taiwan: March exports are expected to increase by approximately 10% YoY, aligning with the average growth rate of 9.7% observed in Jan-Feb. CPI inflation is forecasted to register a 2.1% YoY increase in March, also consistent with the 2.4% recorded in Jan-Feb. The impact of the April Hualien earthquake is expected to be minimal. While major semiconductor companies have reported temporary production suspensions and personnel evacuations, there have been no significant damages to manufacturing facilities. Leading companies have swiftly restored their production capacities within 24 hours, resulting in minimal disruptions to the supply chain. Moreover, the inventory ratio in Taiwan’s semiconductor and overall manufacturing sector has remained above the historical benchmark level of 1.0. This indicates that companies possess adequate inventories to manage the current situation effectively.

Economics Team

FX: USD's momentum did not gain traction

Let's see if markets end this week in the same direction they started. **Despite the constructive sentiment** towards the USD, the **DXY Index depreciated** by 0.2% to 104.3, **marking the first decline in four weeks**. Last Friday, DXY spiked to 104.7 from 104.2 on a surprise surge in US nonfarm payrolls to 303K in March; consensus had expected a decline to 214k from 270k (revised from 270k) in February. However, the DXY spent the rest of the session returning to 104.3, ignoring the US Treasury 10Y yield rise to 4.40%, its highest level in late November. After bottoming at 100.6 in late December, **DXY consolidated this year in a 102-105 range**.

The greenback dismissed Fed Governor Michelle **Bowman's remark about the Fed's willingness to hike if the progress on inflation stalled**. However, interest rate futures did not entirely remove the expectations for a Fed cut in June; the odds were reduced to 48.8% last Friday from 60.4% a day earlier. While Bowman saw upside risks to inflation from the strong payrolls**, her baseline remains for inflation to fall amid warning of a deteriorating US economy altering the view for rate cuts**. Although the unemployment rate fell to 3.8% in March from 3.9% in February, average hourly wage growth slowed to 4.1% YoY, its slowest since June 2021. On April 10, consensus sees **US CPI and core inflation moderating to 0.3% MoM in March** from 0.4% in February. On the same day, the FOMC Minutes will be a reminder that the Fed is keeping its projection for three rate cuts this year.

The DXY's struggle to rise could also be attributed to the EUR's resilience, its most significant component. EUR/USD failed to push below 1.08 at the start of April on a lower-than-expected CPI inflation fueling bets for the European Central Bank to lower rates before the Fed. EUR appreciated 0.4% to 1.0840 last week after three weeks of selling. With the EU CPI inflation easing a fourth month to 2.4% YoY in March from 2.9% in December, the **ECB should lay the ground for a June rate cut** at this Thursday's governing council meeting. Beyond that, ECB President Christine **Lagarde has communicated her unwillingness to commit to more cuts**.

It is yet to be determined if USD/CAD can push sustainably above 1.36 at tomorrow's Bank of Canada meeting. Since March, the currency pair has returned briefly below 1.35 after failing to hold above 1.36. Although Canada's CPI inflation fell to 2.8% YoY in February, core inflation was 3.2%, above the midpoint of the 1-3% target. While Canada shed 2.2k jobs in March, it added an average 25.3k jobs in 1Q24 vs. 18.4k in 4Q23. The market sees the BOC lowering rates later in September instead of June, a week earlier.

USD/SGD traded in a 1.3450-1.3550 range in the past fortnight. On April 12, we expect the Monetary Authority of Singapore to **keep the three parameters of the SGD NEER policy band unchanged**. Headline inflation rose to 3.4% in February from 2.9%, while core inflation increased to 3.6% from 3.1%, near the top of the official forecast of 2.5-3.5%. On the same day, consensus expects Singapore's advanced GDP to halve to 0.6% QoQ sa in 1Q24 from 1.2% in the previous quarter but rising to 3.1% YoY from 2.2% on base effects.

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