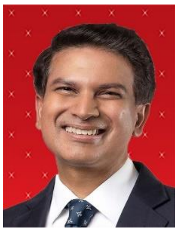
Macro Insights Weekly

What to make of the commodity cycle?

Group Research April 1, 2024



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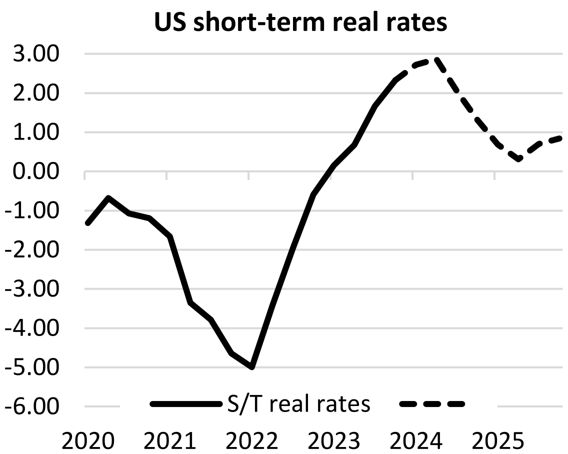
- *A soft patch in commodities helped the global disinflation trend in 2023. But as demand remains resilient, commodities may well have bottomed. This could complicate the inflation picture ahead.*
- *China's demand weakness contributed to the softness in energy and metals prices last year.*
- *US-led supply side response certainly tempered energy prices.*
- *But markets appear buoyed by a likely recovery in Chinese demand.*
- *Additional boost to global commodity supply looks unlikely this year.*
- *While a price surge is unlikely, a commodity turnaround could end the ongoing disinflation trend.*

Key data release and events this week:

- *RBI should keep rates unchanged amid steady headline inflation*
- *Korea's March CPI inflation could stay around 3% y/y*
- *Thailand's negative inflation may extend into March amid energy price drag*

Chart of the Week: Peak in US short-term rates

We think 2Q24 would mark the peak in US short-term real interest rates, defined as the difference between Fed Funds rates and core PCE inflation. Fed policy rate cuts are on the cards from mid-year onward even if core inflation does not ease much more. We however don't expect negative real rates in this cycle as room for rate cuts through 2024/25 may well be limited by some stickiness in inflation and resilient demand.

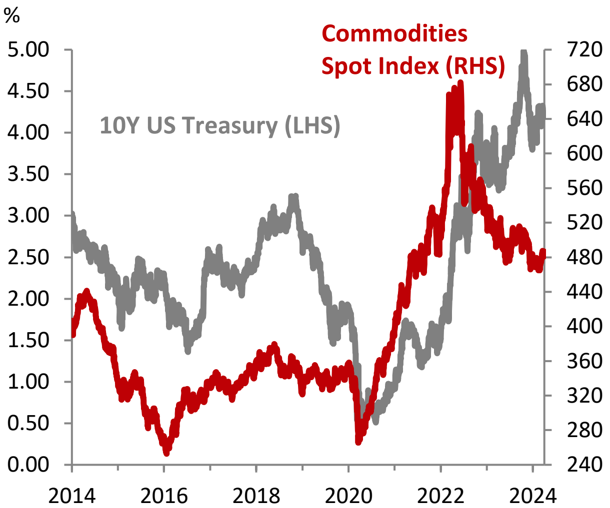


Source: CEIC, DBS. Short-term real rates calculated by taking the difference between end-quarter Fed funds rate and the average core PCE inflation for that quarter.

Commentary: Commodity cycle

A sharp rise in interest rates since 2022 notwithstanding, global economy has been resilient. And yet, the demand side was not strong enough to pull up food and energy prices 2023. On the supply side, despite many worries, primary related to wars and climate change, production of commodities held up well. A surge in investment toward technology-intensive products has not caused a surge in industrial metals prices either. Only gold has done well, which itself is confounding given the high rate of return from risk free bonds and a buoyant equity market.

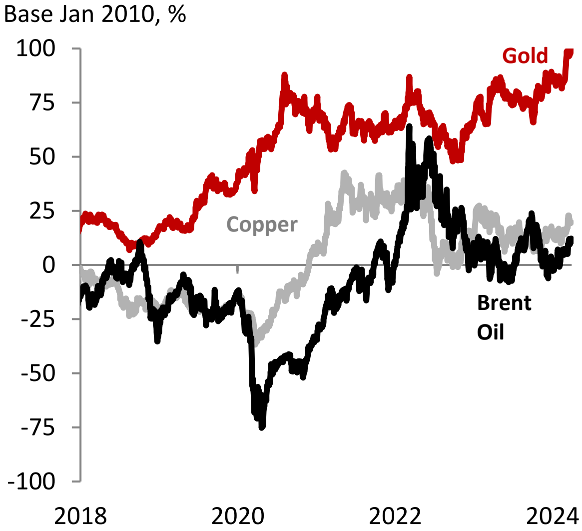
Commodities vs Interest Rates



Source: Bloomberg, DBS

What to make of all this? First, China. In recent decades, China's strong industrial and construction growth fuelled seemingly inexhaustible demand for commodities, a dynamic that has weakened since 2020. At the same time, a move toward green transition has had a sobering impact on fossil fuel prices, Russia's invasion of Ukraine and unrest in the middle-east notwithstanding. Second, on the supply side, the US has pursued numerous channels to prevent geopolitics from spilling into energy prices. From boosting local production and releasing a record 180mn barrels from its strategic reserves in 2022 to arranging for oil and gas supplies to move to Europe seamlessly, the US has played a key role in stabilising the global energy supply.

Brent Oil vs Copper vs Gold



Source: Bloomberg, DBS

But the commodity soft patch may be behind us. Commodity traders are increasingly encouraged by signs of demand bottoming in China. This optimism is reflected in fledgling buoyancy in the markets, as critical commodities like crude oil, cocoa, cotton, sugar, palm oil, nickel, aluminium, and copper rallied in 1Q24. There is also lingering headache with respect to the supply side. An escalation of security risks in Ukraine and the middle-east is always on the cards, threatening to affect the supply-demand balance at a time when global energy inventory levels are lean. We don't think a price surge is around the corner, but a turnaround in commodity prices could well mark the end of the disinflation trend that has soothed equity, bond, and credit markets in the past year.

Taimur Baig

Key forecasts for the week

Event	DBS	Previous
Apr 1 (Mon)		
South Korea: exports (Mar)	9.9% y/y	4.8% y/y
- imports	-8.6% y/y	-13.1% y/y
- trade balance	USD5.8bn	USD4.3bn
Indonesia: CPI (Mar)	2.9% y/y	2.8% y/y
Apr 2 (Tue)		
South Korea: CPI (Mar)	3.1% y/y	3.1% y/y
Apr 3 (Wed)		
Eurozone: CPI (Mar)	2.5% y/y	2.6% y/y
Apr 5 (Fri)		
Philippines: CPI (Mar)		3.4% y/y
Thailand: CPI (Mar)	-0.4% y/y	-0.8% y/y
India: RBI repurchase rate	6.50%	6.50%

Central bank meetings

Reserve Bank of India (5 April): As we head to next week's rate decision, the monetary policy committee (MPC) have additional inputs by way of key global central developments and, domestically, two inflation releases alongside a strong growth outcome, since their last rate review in Feb24. The US FOMC raised its growth, inflation and long-term rate forecasts but left the door open for policy easing this year. Domestically, headline inflation was largely steady around 5% while core hit a series low, with food accounting for the gap. Notwithstanding an improving current account profile, the rupee briefly depreciated to a record low before stabilising. With growth in the first three quarters of FY24 standing at north of 8%, the FY24 growth forecast might be raised, whilst FY25 is maintained at 7%. Given the strong growth momentum and improving external stability indicators, the central bank has the headroom to wait and monitor the progress of the summer's monsoon before moving on rates. Need for further policy transmission is also likely to receive a mention. With markets still debating over the timing of the start of US Fed rate cuts, and the index inclusion around the corner, keeping domestic rates steady is likely to be the preferred decision for the March meeting.

Forthcoming data releases

South Korea: March inflation data is scheduled for release this week. Headline number is expected to remain around 3% YoY after averaging 3.0% in the first two months of this year (smoothing out the Lunar New Year effects). Month-on-month, CPI growth is expected to slow significantly from the 0.5% seen in Jan-Feb. Given the restrictive monetary policy and the diminishing inflation expectations, CPI figures are expected to decelerate further to below 3% in the upcoming months, possibly around August. Presently, the Bank of Korea is maintaining a neutral stance on monetary policy, refraining from premature rate cuts. Nevertheless, as inflation stabilizes around the 2% mark, it may pave the way for a monetary policy shift around mid-year.

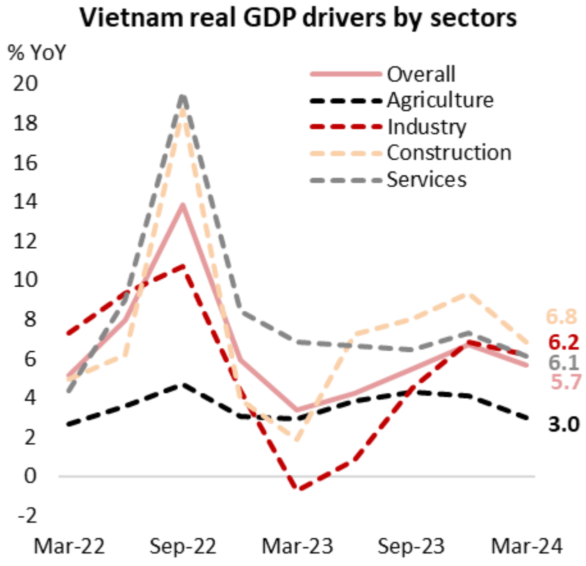
Thailand: We anticipate Thailand's negative headline inflation to extend into March 2024, registering at -0.4% YoY vs February's -0.8% YoY. Energy likely remained the key price drag, given government measures to subsidise electricity and diesel prices. Core inflation while in positive zone likely stayed muted, and below the Bank of Thailand (BOT)'s 1-3% headline inflation target band, which is increasingly tough for the authorities to ignore.

Economics Team

Vietnam: 2024's recovery and FDI interest

Vietnam's external oriented economy remains on track for a gradual growth recovery in 2024. Following 1Q24's GDP release, we maintain our 2024 real GDP growth forecast at 6.0%, picking up from 2023's muted 5.0%.

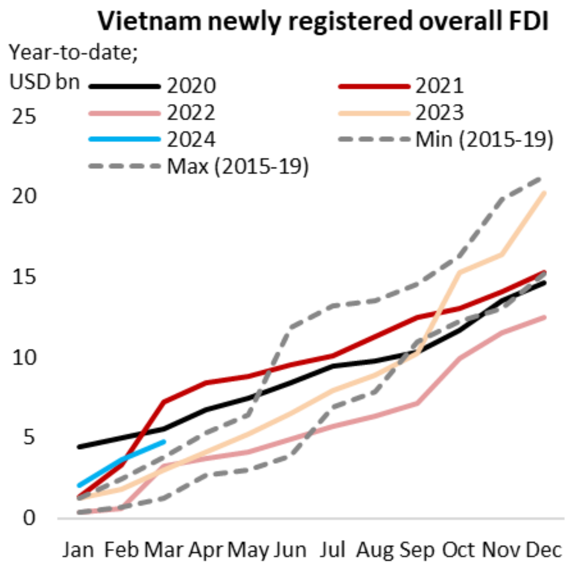
1Q24 real GDP growth came in at 5.7% YoY, which was much quicker than 1Q23's 3.4% YoY, although softer than 4Q23's 6.7% YoY. Softer 1Q growth vs 4Q tends to happen historically, and should not be viewed negatively.



Source: CEIC, DBS

We expect Vietnam's recovery to be mainly driven by an uptick in export-oriented manufacturing activity. The industrial sector expanded by 6.2% YoY in 1Q24, already turning around from 1Q23's 0.7% contraction, and looks set to improve gradually. Notably, Vietnamese electronics exports, the largest goods export product at ~30% of total, are likely to continue to benefit from the global electronics cycle's modest uptick. Global demand is improving with inventory set to normalise after 2023's significant digestion, alongside a tech replacement cycle.

1Q24 services growth of 6.1% YoY was softer than 1Q23's 6.9% YoY and 4Q23's 7.3% YoY. Yet, we think that services expansion should be supported by steady labour market conditions, and continued recovery in foreign tourist arrivals. 1Q24 foreign tourist arrivals reached 4.6mn, exceeding 1Q19 pre-pandemic numbers by ~3%.



Source: CEIC, DBS

We continue to expect Vietnam to be a foreign direct investment (FDI) darling in the region. Despite growth volatility, FDI inflows, especially from manufacturing, remain forthcoming. 1Q24 overall newly registered overall FDI was above 1Q23 and the 1Q pre-pandemic high between 2015 to 2019. While Singapore continues to be Vietnam's largest foreign investor, Chinese's investor interest has continued to grow in prominence. Mainland China's share of total FDI inflows rose to a multi-year high of 17.6% in 2023 vs 6.6% in 2017. Chinese firms continue to view Vietnam as an attractive destination to diversify and de-risk their supply chains, amid persistent geopolitical tensions, with geographical proximity an added advantage.

Chua Han Teng

FX: Looking for respite from USD strength

DXY was barely changed at 104.5 last week after two weeks of appreciation. This week, Fed Chair Jerome Powell and many Fed officials will speak about the economic outlook and monetary policy. They will rule out a rate cut at the FOMC meeting on May 1 but support the three reductions reaffirmed in the Summary of Economic Projections. **Interest rate futures continued to see the first Fed cut in June.** Although the PCE deflator rose to 2.5% YoY in February from 2.4% in January, it remained near the 2.4% the Fed projected for 4Q24. Similarly, the PCE core deflator edged closer to the Fed's 2.6% target, declining to 2.8% from 2.9% for the comparable period.

With inflation down from its multi-decade highs, the Fed is also paying attention to achieving maximum employment in its dual mandate. **Given the market's recent inclination to reduce rate cut bets, the DXY can soften again if Friday's US monthly jobs report disappoints.** Consensus expects US nonfarm payrolls to add 200k jobs in March, fewer than the 275k in February. It also sees average hourly earnings growth slowing to 4.1% YoY from 4.3% and the unemployment rate slowing to 3.8% from 3.9%.

EUR/USD depreciated the third week by 0.2% to 1.0790, **stabilizing around 1.08** after the 0.7% sell-off the previous week. No one expects the European Central Bank to lower interest rates at its next meeting on April 11. On April 3, consensus sees the EU CPI estimate and core inflation holding above the official 2% target in February, at 2.5% YoY and 3%, respectively. The OIS market discounted four rate reductions this year in June, July, September, and December. However, ECB President Christine Lagarde is unwilling to commit to a path beyond the rate cut expected in June. ECB Chief Economist Philip Lane said the ECB needed to be more confident about normalizing wage growth and inflation returning to the 2% target to reverse the past rate increases.

GBP/USD stabilized in a 1.2570-1.2670 range after its plunge from 1.28 on March 21-22. UK's CPI inflation had plunged a day earlier to 3.4% YoY in February from 4% in January and core inflation to 4.5% from 5.1%. Bank of England Governor Andrew Bailey became less worried about second-round effects compared to a year ago. The OIS market sees the BOE lowering interest rates three times this year in June, September, and November. With inflation above the 2% target, BOE hawk Jonathan Haskel thought rate cuts were "a long way off" while Catherine Mann reckoned that the markets were pricing in too many cuts. Finally, the BOE will release, on April 12, the independent review by former Fed Chair Ben Bernanke on its forecasting and related processes amid significant uncertainty.

USD/JPY consolidated in a 151.2-151.5 range after failing to break above 152 on March 27. Japanese government officials have considered the JPY's recent sharp depreciation unusual and undesirable and have ratcheted up verbal warnings without ruling out any options against excessive currency moves. Tokyo CPI inflation rose a second month to 2.6% YoY in March after a brief dip below the 2% target to 1.8% in January. Today's stronger-than-expected Tankan report should also support the case for more monetary policy normalization in Japan.

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