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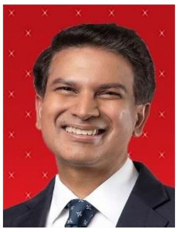
DBS

Macro Insights Weekly

Complacent markets

Group Research

January 29, 2024



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- *Strong real GDP growth numbers and soft inflation figures have set the US markets ablaze. We welcome market rallies, but are wary of complacency among market participants.*
- *US stock market has been setting records and volatility markers have collapsed.*
- *Credit spreads have compressed to nearly all-time lows.*
- *US market cheer however has not had a salutary impact worldwide.*
- *Non-AI chip demand softness and risk of delays in Fed cuts are weighing in.*
- *Near term market risks include oil prices and resiliency of the US labour market.*

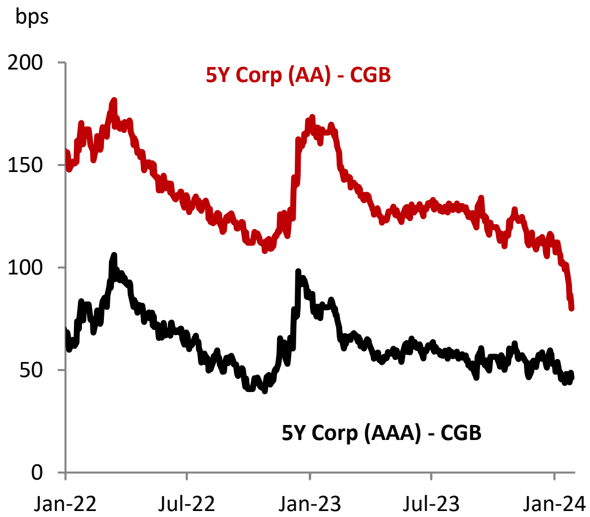
Key data release and events this week:

- *HK's GDP growth should have accelerated from 4.1% YoY in 3Q to 5.3% in 4Q.*
- *Taiwan's 4Q GDP growth is likely to increase to 3.7% YoY from 2.3% in 3Q.*
- *China's PMI is expected to edge down from 49.0 in Dec23 to 48.9 in Jan24.*

Chart of the Week: Easing China credit stress

Between statements from top leadership for forceful measures to improve the investment environment, and PBOC easing measures, China's currency and equity markets have received much needed relief lately. More crucially, a flurry of new property market support measures has cheered the credit markets, with a sharp compression of spreads. Chinese asset markets have been cheap for a while, now they seem to be offering value.

China: Onshore Credit Spreads

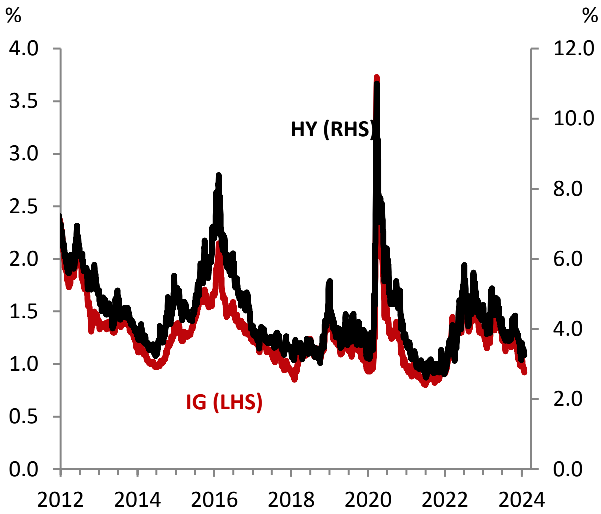


Source: Bloomberg, DBS

Commentary: Complacent markets

Strong real GDP growth numbers (2.5%yoy for 2023) and soft inflation figures (core PCE below 3%yoy in December) have set the US markets ablaze. From stocks to bonds to credit, a sharp rally has been underway for a month. The US stock market has been setting records, volatility markers have collapsed, and credit spreads have compressed to nearly all-time lows. Inflation may have a few more months to go before the Fed's target is reached, but as far as the US markets are concerned, things haven't been this good in a very long time.

Credit Spreads - US Corporate

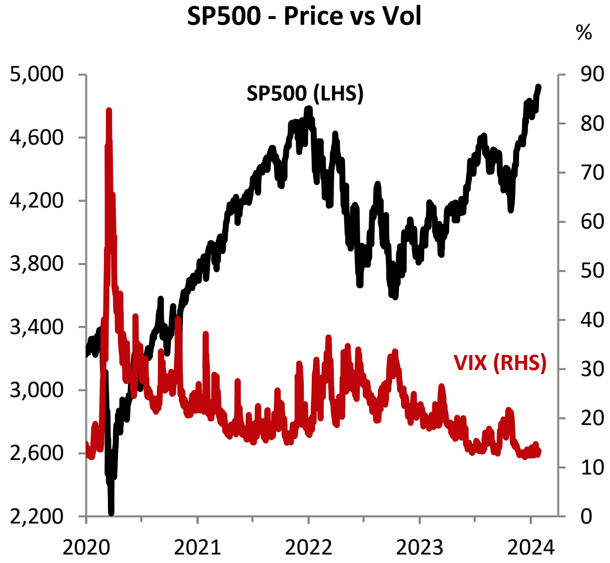


Source: Bloomberg, DBS

10Y UST yield - SP500 Dividend yield

Source: Bloomberg, DBS

SP500 - Price vs Vol



Source: Bloomberg, DBS

US market cheer has not had a salutary impact worldwide. In Asia, news about strong US domestic demand is contrasted by somewhat underwhelming electronics demand (with the exception of AI-related chips) and some nervousness about US rate cuts getting delayed. Regional stock markets, from India to Indonesia, South Korea to Taiwan, have not managed to show gains commensurate with the S&P500's performance so far this year.

Looking ahead, oil is the key near-term risk, with the security situation in the Middle-East, particularly the Red Sea, causing some nervousness. A couple of additional strong labour market prints in the US would also displease sentiments, as such good news would be seen as bad news for the Fed rate cut scenario. Beyond that, in our view, the soft-landing scenario remains intact, which may not be particularly supportive for markets that are already trading at lofty valuations. We welcome market rallies, but are wary of complacency among market participants.

Taimur Baig

Key forecasts for the week

Event	DBS	Previous
Jan 29 (Mon)		
Vietnam: exports (Dec)	35.4% y/y	13.1% y/y
- imports	30.5% y/y	12.3% y/y
- trade balance	USD2.1bn	USD2.3bn
- Retail sales YoY YTD	10.5% y/y	9.3% y/y
- CPI	3.5% y/y	3.6% y/y
Jan 31 (Wed)		
China: manufacturing PMI (Jan)	48.9	49.0
Hong Kong: GDP (4Q A)	5.3% y/y	4.1% y/y
Japan: industrial production (Dec P)	0.6% y/y	-1.4% y/y
South Korea: industrial production (Dec)	9.2% y/y	5.3% y/y
Taiwan: GDP (4Q A)	3.7% y/y	2.3% y/y
Feb 1 (Thu)		
Hong Kong: retail sales value (Dec)	13.0% y/y	15.9% y/y
Indonesia: CPI (Jan)	2.6% y/y	2.6% y/y
South Korea: exports (Jan)	2.2% y/y	5.1% y/y
- imports	-16% y/y	-10.8% y/y
- trade balance	-USD2.19bn	USD4.48bn
Feb 2 (Fri)		
South Korea: CPI (Jan)	2.7% y/y	3.2% y/y

Central bank policy meetings

Bank of England (Feb 1): We anticipate no change to the bank rate, which has been unchanged at 5.25% since the last hike in August. BOE should mirror the other central banks' concern about sticky inflation and push back the market's aggressive bets for five rate cuts this year starting in May. UK's CPI inflation increased to 4% YoY in December after hitting a 26-month low of 3.9% in November. Core inflation stalled at the same 5.1% rate as November, well above the 2% target. BOE will likely flag disruption risks from the Red Sea crisis lifting oil prices this month. It will probably monitor the possibility of tax cuts in March, implied by Chancellor of the Exchequer Jeremy Hunt's latest warning that the UK economy could already be in recession.

Forthcoming data releases

China: The anticipated slowdown in manufacturing PMI is expected to continue, decrease from 49.0 in Dec to 48.9 in Jan, marking the fourth consecutive month of slowdown. High-frequency data for January, such as the operating rate on major steel mills and asphalt plants, has retreated from December levels. The cement shipping rate also dropped from 39% at the beginning of December to 29% in the most recent available data. The expectation is that new export orders will continue to be restrained by external demand from the rest of the world in the midst of high interest rates.

Hong Kong SAR: GDP growth is expected to accelerate from 4.1%YoY in 3Q to 5.3% in 4Q, primarily due to an extended low-base effect. On the consumption front, retail sales growth is projected to ease slightly from 15.9% YoY to 13.0% YoY. The weak asset markets are adversely affecting consumer confidence through a negative wealth effect. The robust HKD is constraining the spending capacity of tourists and encouraging local residents to travel abroad. In December 2023, mainland tourist arrivals were around 2.9 million, marking a 43% decline from 2018. Chinese tourist spending per day also witnessed decreases, with a 14% drop for overnight visitors and a 48% decrease for day-trippers compared to 2018. On trade, external demand from Mainland China and the rest of the world is expected to continue facing challenges due to high interest rates. The value of total exports of goods decreased by 7.8% YoY in 2023, while simultaneously, the value of imports of goods decreased by 5.7% YoY. Meanwhile, investment sentiment was subdued amid the prolonged interest rate up-cycle.

South Korea: The focus this week lies on January trade and inflation data. Exports are expected to sustain a low single-digit growth for the fourth consecutive month, standing at 2.2%

YoY. Meanwhile, CPI inflation is expected to exhibit a notable deceleration, dropping below the 3% threshold to 2.7% YoY. The modest growth in exports and the easing of inflationary pressures are likely to bolster the case for BOK rate cuts starting from 2Q. The preliminary GDP estimate released last week also highlighted that the 2.2% YoY growth in 4Q was primarily propelled by net exports, while domestic demand remained subdued in the face of a high-interest-rate environment.

Taiwan: The preliminary estimate for 4Q GDP is likely to show an acceleration in growth to 3.7% YoY, surpassing the 2.3% recorded in 3Q and marking the highest figure in five quarters. The primary driving force is expected to be exports, aided by the recovering demand in the global electronics and semiconductor industry. On the flip side, investment continues to lag, hampered by lingering excess capacity in the manufacturing sector that has yet to be fully absorbed, and capacity utilization has not yet returned to normalized levels. Consumption growth is expected to decelerate, attributed to the dissipation of reopening-related demand. For the full year of 2023, overall growth is projected to conclude at 1.1%, marking the lowest level observed since 2010.

Vietnam: We expect goods export to surge by 35.4% YoY in Jan 2024, from Dec 2023's 13.1% YoY, supported by favourable base effect, and a continued improvement in electronics shipments. Vietnam's electronics exports are likely to benefit from an uptick in global demand, and handset upgrades following the launch of Samsung's new series of mobile devices in Jan 2024. Retail sales also likely inched higher in Jan 2024, as household spending was supported by a resilient labour market and the ongoing tourism recovery.

Headline inflation likely remained steady at 3.5% YoY in Jan 2024, vs Dec 2023's 3.6%. Healthcare prices were adjusted up from Nov 2023 to align prices nationwide. Transport inflation likely contributed modestly to the headline rate, while food inflation remained contained.

Indonesia: The first inflation print for 2024, due this week, is likely to post a flat reading at 2.6% yoy for Jan24. Administrative measures and base effects are moderating yoy rise in rice prices, whilst few other pockets like cooking oil, sugar etc. are off lows. Disruptions in the Red Sea are yet to filter into manufacturing input costs and oil prices, helping to keep Indonesia's inflation within the revised 1.5-3.5% target in an election year. Core inflation is expected to diverge from the headline and stay below 2%, also pointing to subdued demand dynamics.

India: The government will table the FY25 vote-on-account or the Interim Budget on 1 February, ahead of the general elections in April/ May. After the polls, the incoming administration will present the regular Budget around mid-2024. Taking a leaf off the pre-election 2019 Budget, we expect this interim edition to propose modest pro-demand steps to address near-term risks. We expect the FY24 fiscal deficit target at -5.9% of GDP to be met, despite an anticipated miss in the nominal GDP growth. For FY25, we expect the fiscal deficit to be pegged at around the -5.3% of GDP mark. For further details, please read India's interim budget to retain a progressive outlook.

Economics Team

FX: Resilient USD vs. GBP and EUR

The USD Index (DXY) remained resilient above 103 throughout the US Federal Reserve's blackout period. As of last Friday, DXY appreciated 4.1% ytd to 103.4 in the first month of 2024, following the sharp 4.6% depreciation to 101.3 in the final quarter of 2023. Going into the FOMC meeting on 30-31 January, **Fed officials maintained a firm stance against market expectations for an early interest rate cut in March**.

Following the US data surprises this month, the **Fed should be more confident about a soft landing and push back against the market's bets for 150 bps of rate cuts this year**, twice the Fed's projection in last month's Summary of Economic Projections. Following the PCE core deflator's decline below 3% for the first time since March 2021, some market participants are hanging on to their aggressive bets, hoping this Friday's nonfarm payrolls decline below 200k again to 180k in January. However, the Fed will also pay attention to the unemployment rate holding steady around 3.7-3.8% for a sixth month, also noting that average hourly earnings growth has yet to slow below 4% YoY. **The Fed will monitor the Red Seas crisis, propelling WTI crude oil prices** by 9% this month after the 21% decline in 4Q23.

GBP/USD faces downside risks inside the 1.26-1.28 range, which started in mid-December. The Bank of England should keep the bank rate unchanged at 5.25% at its policy meeting on 1 February. BOE should mirror its peers in pushing against rate cut bets on sticky inflation. In December, CPI and core inflation held above 4% and 5%, respectively, well above the 2% target. However, Chancellor of the Exchequer Jeremy Hunt warned that the UK economy could already be in recession, sparking speculation of tax cuts in March. GBP has a legacy of not handling fiscal spending plans to support growth when the BOE needs to rein in inflation. The Institute of Fiscal Studies reckoned the government that wins the next election would need to raise more tax than it spends to stabilize government debt. GBP/USD must break below its 50-day moving average (1.2670) before it can test the floor of its 1.26-1.28 range again and push towards its 100-day moving average (1.2465).

EUR/USD exhibits a downward bias after multiple failed attempts to close above 1.09. The European Central Bank has a clearer timetable and strategy to normalize interest rates vs. its Developed Market peers. ECB President Christine Lagarde said rate cut discussions could start after the ECB completed its review by the end of spring, which falls between March and May in Europe, to determine the sustainability of the disinflation trend towards its 2% target. The **EU economy could report a mild technical recession a day after the FOMC meeting**. Consensus expects 4Q23 real GDP to contract at the same 0.1% QoQ sa pace as 3Q23. EUR/USD could eye the support level around 1.0750, near the lows in early December and its 100-day MA (1.0780).

Today, the **Monetary Authority of Singapore kept all three parameters** – mid-point, slope, and width – **of its SGD NEER policy band unchanged.** Despite the upticks in December's inflation, the MAS lowered its headline CPI inflation forecast for 2024 to 2.5-3.5% from 3-4% previously. Stripping out the impact of the GST increase implemented this month, the central bank's forecasts for headline and core inflation this year have converged at 1.5-2.5%. We maintain the view for the MAS to slightly decrease the slope of its policy band in the second half of the year, aligning with our call for the Fed to cut rates by 100 bps.

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