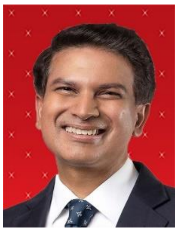
Macro Insights Weekly

Assessing disinflation

Group Research January 15, 2024



Taimur Baig
Chief Economist
taimurbaig@dbs.com

Radhika Rao
Senior Economist
radhikarao@dbs.com

For Alliance Bank clients, please direct your enquiries to Malaysia Research +603 2604 3915 general@alliancedbs.com

- *Global inflation has come down considerably in the past year or so. But the last mile of disinflation, i.e., the journey toward the inflation target of central banks, is likely to be bumpy.*
- *Goods prices are now subtracting from inflation, but there may not be much downside left*
- *Services disinflation can only take hold if job losses mount*
- *Continued rental disinflation would need support from the supply side*
- *Shipping and insurance costs are key risks in the near term around Red Sea tensions*
- *Food inflation may become a perennial risk around climate change*

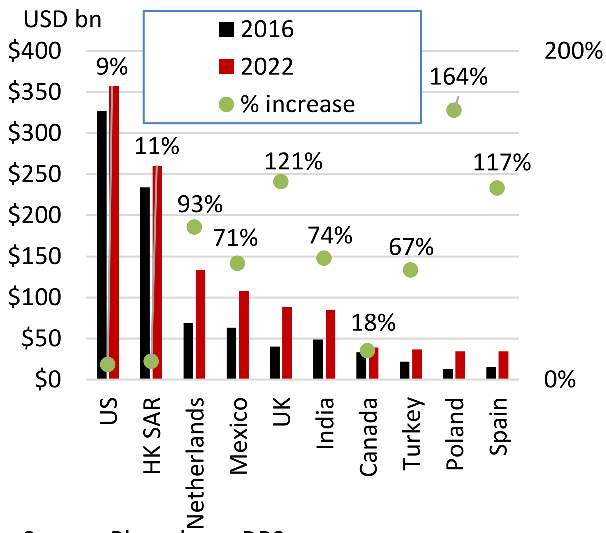
Key data release and events this week:

- *China's headline growth likely grew 5.1% YoY in 4Q23.*
- *Bank Indonesia is expected to keep rates on hold this week*
- *We expect Malaysia's 4Q23 advance real GDP growth to recover to 4.1% yoy*

Chart of the Week: China's trade surplus

Despite trade war, as well as pandemic related disruption and ongoing re-orientation of the global supply chain, China's trade surplus has gone from strength to strength in recent years, rising to USD877bn in 2022, a 72% rise over 2016. Key trading partners have barely changed positions during this period, although various political and economic dynamics are seen in the spikes seen vis-à-vis Mexico, several European countries, India and Turkey.

China's trade surplus by country

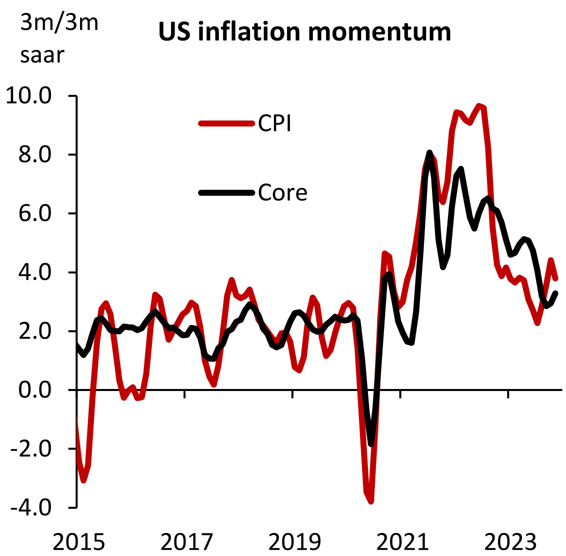


Source: Bloomberg, DBS

Commentary: Assessing disinflation

Global inflation has come down considerably over the past year. Manufactured goods prices stabilised around supply chain normalisation through the course of 2023, while energy prices eased with some improvement in production. Food production was not hampered meaningfully by El Niño, while movement of grains from Russia/Ukraine was not disrupted by the ongoing war. Consequently, both headline and core inflation rates roughly halved relative to 2022, a big relief for policy makers and some respite for beleaguered consumers.

The pace of disinflation has been rapid. In the US, we measure headline inflation momentum declining from over 9.5% in mid-2022 to 3.3% at end-2023, while core inflation has followed a somewhat similar pattern. Goods prices are now subtracting from inflation, a far cry from the pandemic days. The latest inflation prints are almost entirely driven by rent and financial services. Accordingly, inflation expectations, measured both by surveys and through bond market pricing, have begun to ease as well.



Source: CEIC, DBS

Asia did not see as high inflation in 21/22 as the US, largely due to demand impulse being much weaker. Hence prices did not plunge in the region last year, but nonetheless eased appreciably, especially with respect to food. We estimate regional food inflation momentum at minus 3.5% and core inflation momentum at 1.5%, opening up room for monetary policy pause, followed by some easing this year.

Will the disinflationary trend continue? Perhaps, but the last mile of disinflation, i.e., the journey toward the inflation target of key central banks, is likely to be bumpy, in our view. Consider the following factors, which would cautious against declaring victory over inflation in the near term:

- The path will be informed by financial market conditions, which have eased substantially since December due to sharp bond and stock market rallies.
- Liquidity is ample, hardly a constraint for consumers and firms.
- Further services disinflation can only take hold if job losses mount in finance and technology, evidence of which is scant.
- Continued rental disinflation would need support from housing construction, which is picking up in the US, but may take time to matter.
- Shipping and insurance costs are key risks in the near term around Red Sea tensions. Already, Shanghai shipping freights rates have doubled since mid-December.
- Finally, food inflation, currently providing respite, may turn volatile this year around wars and inclement weather.

Taimur Baig

Key forecasts for the week

Event	DBS	Previous
Jan 15 (Mon)		
Indonesia: exports (Dec)	-7.7% y/y	-8.6% y/y
- imports	-1.8% y/y	3.3% y/y
- trade balance	$2.5bn	$2.4bn
India: exports (Dec)	-10.7% y/y	-2.8% y/y
- imports	-11.8% y/y	-4.3% y/y
- trade balance	-$20bn	-$20.6bn
Jan 17 (Wed)		
Singapore: NODX (Dec)	3.0% y/y	1% y/y
China: GDP (4Q)	5.1% y/y	4.9% y/y
Industrial production (Dec)	6.0% y/y	6.6% y/y
FAI ex rural (YTD)	2.9% y/y	2.9% y/y
Retail sales (Dec)	7.6% y/y	10.1% y/y
Indonesia: BI 7D reverse repo	6.00%	6.00%
Jan 19 (Fri)		
Japan: CPI (Dec)	2.5% y/y	2.8% y/y
Malaysia: exports (Dec)	-3.2% y/y	-5.9% y/y
- imports	5.4% y/y	1.7% y/y
- trade balance	MYR18.1bn	MYR12.4bn
Malaysia: GDP (4Q)	4.1% y/y	3.3% y/y

Central bank policy meetings

Bank Indonesia (Jan 17): India & Indonesia: Indonesia's inflation remained within the BI's target towards end-2023, providing comfort to the policymakers. A pause on rates is likely this week. We expect the policymakers to exhibit a lower urgency to shift towards an easing cycle in 1H24 to preserve finance stability and anticipate a lift in the headline inflation back above 3% in first half of the year on receding base effects, religious holidays, tariff adjustments and higher food. On the trade front, we expect base effects and slowing growth in key trading partners to keep export growth in negative. The moderate levels of Brent oil will provide relief to the import bill in both the countries, even as the discount purchase price for Russian oil has narrowed in recent months. We expect India's trade balance to register around $20bn deficit whilst Indonesia's surplus continues to narrow to $2.5bn compared to 1H23 monthly average of $3.3bn.

Forthcoming data releases

China: Our nowcasting model pointed to a 5.1% YoY growth in 4Q23, with the full year expansion likely meet the government's target of 5.0%. The PBOC maintained the 1-year MLF rate at 2.50% this morning, but we think a cut 25bps cut in the RRR is around the corner. Retail sales are expected to slow from 10.1% YoY in Nov to 7.6% YoY in Dec, largely due to the dissipation of the low base effect. Consumer sentiment also remains muted due to the negative wealth effect from the real estate sector. Industrial production is anticipated to contract from 6.6% YoY in Nov to 6.0% YoY in Dec. Manufacturing PMI has further slowed to 49.0 in Dec, recording the 3rd consecutive month of slowdown. The weak property market has weighed heavily on production. Meanwhile, export-related production also remains subdued. Trade partners' manufacturing PMI, such as the US, Euro, Japan, and ASEAN, stayed in contraction territories in Dec. Fixed asset investment is projected to stay at Nov's level at 2.9% YoY YTD, with investments in strategic sectors such as infrastructure, EVs, and renewables offsetting the shortfall in property investment.

Japan: Inflation data is set to be released this week. Initial reports from Tokyo suggest a further 0.3ppt decline in the national CPI, reaching 2.5% YoY in December, down from 2.8% in November. This deceleration is primarily attributed to decreases in fresh food and energy prices. Projections indicate that the core-core CPI will ease only marginally by 0.1ppt, maintaining at 3.7% in December compared to 3.8% in November. Against the backdrop of policymakers patiently awaiting the results of this year's Shunto negotiations and considering the impact of recent earthquakes, there will be no change in the policy stance at the Jan 22-23 BOJ meeting.

Malaysia: We expect Malaysia's 4Q23 advance real GDP growth to recover to 4.1% year-on-year (YoY) from 3Q23's 3.3% YoY. Headline growth was likely driven by the industrial's sector gradual turnaround in 4Q23, with Dec 2023 exports also likely improving, notwithstanding a still challenging global economic environment. Services growth likely stayed resilient, supported by continued wage and employment gains, as well as the ongoing foreign tourism recovery. The construction sector also likely extended its robust gains in 4Q23, on the back of further progress in infrastructure projects.

Singapore: Singapore's non-oil domestic exports (NODX) likely extended their YoY expansion to 3.0% in Dec 2023, from Nov's 1.0% YoY increase, in our view. Base effects became more favourable in 4Q23, and will likely be supportive in 2024. The expansion in new export orders of the manufacturing purchasing managers' index (PMI) signalled ongoing improvement in overseas shipments, despite a still uncertain global economic climate. We continue to watch for a turnaround in electronics exports.

Economics Team

FX: Attention shifts from the Fed to other central banks

DXY has an upward bias within the narrow 102.1-102.6 range of the past week. With the US markets closed on Martin Luther King Jr. Day, there is anticipation around Wednesday's import prices echoing the recent mildness in PPI inflation. This week, Fed speakers should keep tempering the market's rapid rate cut bets ahead of the next week's blackout period ahead of the FOMC meeting on 30-31 January. Fed officials will not support a rate cut in March or stray from the three reductions projected in last month's dot plot. The focus should shift towards three central bank meetings next week: the Bank of Japan on 23 January, the Bank of Canada on 24 January, and the European Central Bank on 25 January.

USD/JPY may challenge the top of its recent 143.5-146.5 trading range. No one sees the Bank of Japan to end its negative interest rate policy at its upcoming meeting. However, BOJ might lower its GDP growth forecast for fiscal 2023, ending in March 2024, from the current 2%. Real GDP contracted 0.7% QoQ sa during the June-September 2023 quarter, followed by an “extreme” earthquake in the Ishikawa Prefecture and other parts of central Japan on New Year's Day. National CPI data release on January 19, anticipated to show a slowdown to 2.6% YoY in December from 2.8% in November, could provide the BOJ with a rationale to adjust its inflation forecast for fiscal 2023. The Spring Wage negotiations will be crucial for the BOJ to achieve its 2% inflation target.

GBP/USD faces downside risks as it near the upper limit of its month-long 1.2610-1.2830 range. On 16 January, BOE Governor Andrew Bailey will address the House of Lords Economics Affairs Committee, discussing the UK's growth outlook for 2024, the labour market status, and the expected trend of long-term real interest rates. Weaker employment and inflation data expected on Tuesday and Wednesday could reinforce bets for inflation to drop below the 2% target and leading to earlier rate cuts in May-June. Consensus sees headline inflation decreasing to 3.8% YoY in December, down from 3.9% in November, and core inflation moderating to 4.9% from 5.1%.

USD/CAD may shift to a higher 1.34-1.3450 range after failing to break below 1.3350 last week. Today’s BOC business and consumer outlook surveys improve from relaxed financial conditions from a 100 bps drop in the 10Y bond yield and a 12% rebound in the TSX Composite Index from October's low. Still, tomorrow’s CPI data could decline by 0.3% MoM December (as per consensus), contrasting with the 0.1% rise in November, and notably different from the US CPI inflation's increase to 0.3% MoM from 0.1% for the same period. If so, BOC will find it more challenging than the Fed to discourage premature rate cut expectations.

EUR/USD started the year in a narrow 1.09-1.10 range. Although EU CPI inflation rose to 2.9% YoY in December from 2.4% in November, it remained lower than its US counterpart for the third month. ECB President Christine Lagarde believed that interest rates have peaked but insisted on the need for certainty regarding inflation's return to the 2% target before considering rate cuts. Chief Economist Philip Lane stated that the ECB would wait until June to evaluate the data before arriving at a decision to reduce rates.

Philip Wee

Group Research

Economics & Strategy

Taimur BAIG, Ph.D.
Chief Economist
Global
taimurbaig@dbs.com

Wei Liang CHANG
FX & Credit Strategist
Global
weiliangchang@dbs.com

Tracy Li Jun Lim
Credit Analyst
USD Credit
tracylimt@dbs.com

Amanda SEAH
Credit Analyst
SGD Credit
amandaseah@dbs.com

Nathan CHOW
Senior Economist
China/HK SAR
nathanchow@dbs.com

Eugene LEOW
Senior Rates Strategist
G3 & Asia
eugeneleow@dbs.com

Daisy SHARMA
Analyst
Data Analytics
daisy@dbs.com

Han Teng CHUA, CFA
Economist
Asean
hantengchua@dbs.com

Teng Chong LIM
Credit Analyst
SGD Credit
tengchonglim@dbs.com

Joel SIEW, CFA
Credit Analyst
SGD Credit
joelsiew@dbs.com

Mo JI, Ph.D.
Chief Economist
China/HK SAR
mojim@dbs.com

Tieying MA, CFA
Senior Economist
Japan, South Korea, Taiwan
matieying@dbs.com

Mervyn TEO
Credit Strategist
USD Credit
mervynteo@dbs.com

Byron Lam
Economist
Hong Kong
byronlamfc@dbs.com

Radhika RAO
Senior Economist
Eurozone, India, Indonesia
radhikarao@dbs.com

Samuel TSE
Economist
China/HK SAR
samueltse@dbs.com

Violet LEE
Associate
Publications
violetleeyh@dbs.com

Philip WEE
Senior FX Strategist
Global
philipwee@dbs.com

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