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Macro Insights Weekly

Rate cuts? Not so fast

Group Research

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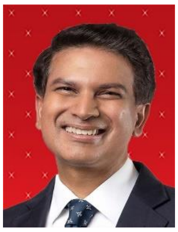

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- *2023 ended with global markets in euphoria over likely near-term rate cuts in the US, with both the fixed income and equity markets rallying. We think the market is getting ahead of itself.*
- *Granted, without Fed easing, real short-term rates would rise in 1H24 as inflation eases further.*
- *But long-term real rates are already at a 5-month low, thanks to recent market rally.*
- *Equity markets have rallied robustly, adding up to an overall easing of financial conditions.*
- *Meanwhile, real economic activities and hiring data remain strong.*
- *Given this dynamic, we think Fed officials would wait till mid-year before easing.*

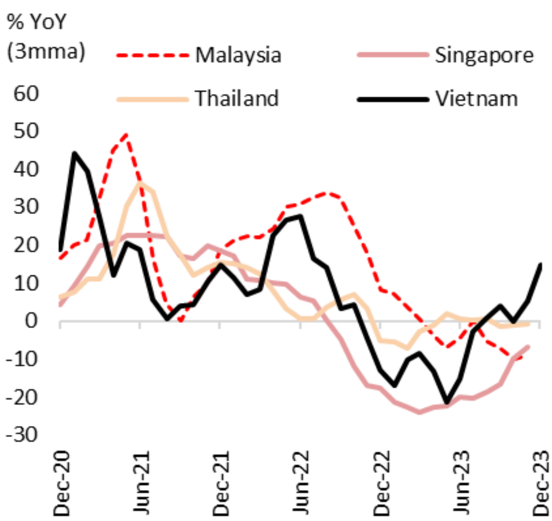
Key data release and events this week:

- *We expect the Bank of Korea to maintain the policy rate at 3.50%.*
- *India's CPI is projected to edge up from 5.6% yoy in Nov to 5.8% in Dec.*
- *CPI of China should have stayed at -0.5% yoy in Dec.*

Chart of the Week: Exports momentum rising

After a prolonged slump, regional exporters have reasons to be hopeful for a better trade outturn in 2024. Electronics exports, in particular, are picking up with advance orders and inventories data pointing to gathering upside. Already, Singapore and Vietnam are showing sure signs of an emerging rebound. Commodity exporters, however, may have less to cheer for with an overall dampening of commodity prices worldwide.

Electronics exports have bottomed



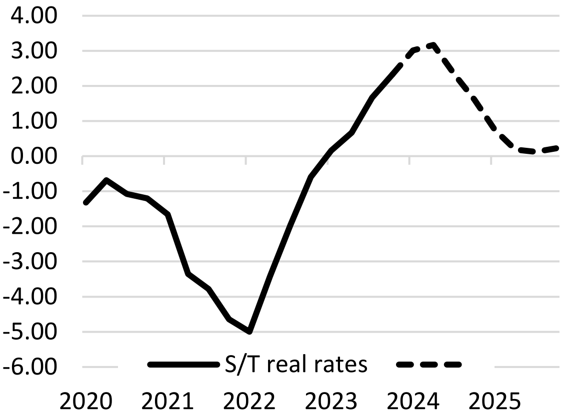
Source: CEIC, DBS. Note: % YoY (3mma) in USD terms

Commentary: Rate cuts? Not so fast

2023 ended with global markets in euphoria over likely near-term rate cuts in the US, with both the fixed income and equity markets rallying. The US Federal Reserve's statement in the last meeting of the year, along with Chair Powell's comments at his press conference, ignited expectations that 2024 will be characterised by multiple and substantial interest rate cuts, as inflation will fade further and the economy will cool. Latest pricing indicates expectations solidifying around at least five rate cuts this year, with the first easing measure coming as early as late-Q1.

Given that both headline and core inflation rates have come off considerably in recent months, there are grounds for optimism. When looked at from the lens of the short term, declining inflation has pushed up real interest rates substantially, and if the Fed the doesn't cut rates in 1H24, they would rise a tad more in the coming quarters. With real rates up by more than 700bps since the bottom of 1Q22, surely there is a need to prevent further increases.

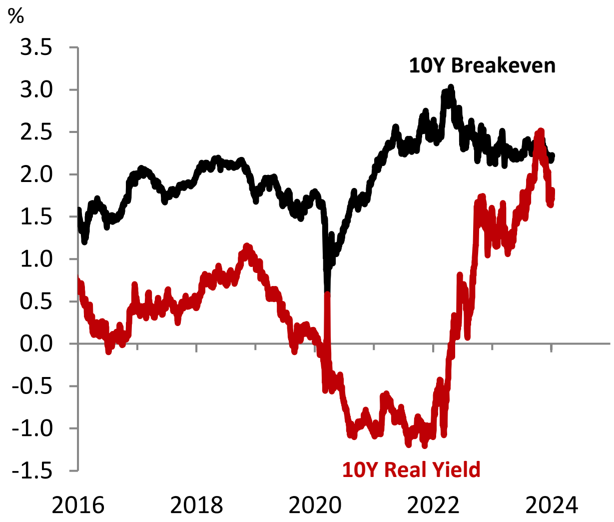
US short-term real rates



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.

But this perspective is muddled considerably if the lens is extended beyond short-term rates. Real 10-year yields are now at a 5-month low, during which period the S&P500 has climbed by 6%, taking it close to an all-time high. Financial conditions have hence eased considerably, while the economy has hardly cooled.

10Y US Real Yield vs Inflation Compensation



Source: Bloomberg, DBS

Beyond inflation, economic activity indicators and labour market conditions should also play key roles in determining the path of interest rates. There isn't much in support of rate cuts in the near term in that space. The US economy continues to grow at well over 2%, comfortably above trend, while wages (up 4.1%yoy through December) and hiring trends (unemployment at 3.7%, close to historic lows) by no means suggest an economy on the precipice of a slowdown or there being a lack of demand impulse on prices. Even if some slowdown is around the corner, it would come from a position of substantial cyclical strength, hardly warranting monetary policy support.

Also, the key question is if the Fed is in a position to declare victory over inflation in a matter of months. We think that from a balance of risk perspective, Fed officials would find it preferable to wait till mid-year before easing.

Taimur Baig

Key forecasts for the week

Event	DBS	Previous
Jan 8 (Mon)		
Philippines: exports (Nov)	-7.5% y/y	-17.5% y/y
- imports	-2.5% y/y	-4.4% y/y
- trade balance	-USD3.9bn	-USD4.2bn
Jan 9 (Tues)		
China: M2 (Dec)	10.0% y/y	10.0% y/y
Taiwan: exports (Oct)	5.1% y/y	3.8% y/y
- imports	-10.5% y/y	-14.8% y/y
- trade balance	USD9.9bn	USD9.8bn
Jan 11 (Thu)		
South Korea: BOK Base Rate	3.50%	3.50%
Malaysia: industrial production (Nov)	1.5% y/y	2.7% y/y
Jan 12 (Fri)		
China: CPI inflation (Dec)	-0.5% y/y	-0.5% y/y
China: exports (Dec)	1.0% y/y	0.5% y/y
- imports	-1.0% y/y	-0.6% y/y
- trade balance	USD74.3bn	USD68.4bn
India: industrial production (Nov)	3.5% y/y	11.7% y/y
India: CPI (Dec)	5.8% y/y	5.6% y/y

Central bank policy meetings

Bank of Korea (Jan 11): We expect the Bank of Korea to maintain the policy rate at 3.50% during this meeting with a neutral stance. The slight easing of inflation pressures provides some reassurance for the BOK, but it falls short of warranting an immediate rate cut (latest CPI: 3.2% YoY in December). Concurrently, the rebound in household loans suggests a cautious approach by the BOK, discouraging premature rate cuts. Our projection remains unchanged, foreseeing the BOK initiating rate cuts from 2Q onward, bringing the policy rate down to 2.75% by end-4Q. This outlook is based on our expectations of a more pronounced easing of inflation to 2.7% in 1H and 2.2% in 2H. Additionally, the anticipated economic recovery is poised to enhance income condition, mitigating concerns regarding household debt rebound.

Forthcoming data releases

Taiwan: December trade data will be released this week. Exports are projected to grow further by 5.1% YoY, a slight increase from November's 3.8%. Electronics exports will likely lead the growth, given South Korea's earlier report of a substantial 21.8% rise in semiconductor exports for December. Non-electronics exports are expected to remain in contraction, aligning with the softness in global demand, due to tight monetary policies in developed economies, and property market challenges in China. Overall, we maintain the outlook for a U-shaped recovery in Taiwan's exports and real economy throughout 2024.

Malaysia: Nov 2023's industrial production (IP) likely extended its expansion for the second straight month at 1.5% YoY. This indicated stabilisation in factory activity, in line with the bottom seen in the exports contraction, notwithstanding a still challenging global economic environment. Base effects also became more favourable in 4Q23. Malaysia's electronics sector appears to be bottoming, and should benefit from the gradual turnaround in the global electronics cycle in 2024.

India: December inflation is likely to have ticked up on year-on-year stickiness in cereals, pulses, and staples, even as sequential trend stabilised. Supply disruptions and lower-than-estimated farm output has marked a floor for cereals, but administrative measures have helped to arrest the one-sided rise in vegetables. Core inflation, nonetheless, remains subdued at close to 4%yoy, providing the authorities the headroom to keep rates on hold. Distortions due to the change in timing of Diwali festivities between this year and last is a key reason behind the sharp correction in Nov's reading to 3.5% yoy from 11.7% in the previous month.

China: China's exports growth is expected to edge up from 0.6% YoY in Nov to 1.0% in Dec on extended low base effect. In fact, external demand remained tepid. NBS's Export Order sub-PMI fell to the weakest reading of 45.8 in the past 12 months in Dec. Meanwhile, Manufacturing PMI of China's major trading partners such as US, Eurozone, Japan, and ASEAN stayed in contraction territory. Likewise, contraction in imports should have widened from 0.6% to 1.0% amid weak domestic demand. Consumption sentiment remained sluggish on subdued wage growth. Property construction was also lukewarm as reflected by the plummeting real estate investment.

On monetary front, advancement of M2 is projected to stay at 10.0% in Dec. Soaring short-end rates such as R007 pointed to tight liquidity condition. Coupled with the sagging economic condition, CPI is expected to stay at -0.5% YoY in Dec.

Economics Team

FX: The Fed is not the only one pushing back against early and aggressive rate cut bets

The USD's rebound in the first week of 2024 should not be a surprise. The US Federal Reserve reckoned that financial conditions have eased in November-December from the 10Y US Treasury yield retreating near July's lows amid record-high US stock market levels. **The Fed officials speaking this week are neutral to hawkish**; they are unlikely to endorse the market's call for an early rate cut in March or the six cuts this year vs. the three cuts in last month's dot plot.

Central banks meetings & rate expectations as of 5 Jan

Cen bank meeting	BOJ 23 Jan	BOC 24 Jan	ECB 25 Jan	FED 31 Jan	BOE 1 Feb
Policy rate	**-0.10%**	**5.00%**	**4.50%**	**5.50%**	**5.25%**
Futures*	-0.01%	5.01%	4.14%	5.44%	5.18%
10Y government bond yields					
4Q high	0.96%	4.24%	2.97%	4.99%	4.75%
	1 Nov 23	3 Oct 23	3 Oct 23	19 Oct 23	17 Aug 23
5 Jan 24	**0.61%**	**3.26%**	**2.16%**	**4.05%**	**3.79%**
3Q low	0.39%	3.27%	2.36%	3.75%	4.22%
	4 Jul 23	3 Jul 23	18 Jul 23	19 Jul 23	19 Jul 23
	USD/JPY	USD/CAD	EUR/USD	DXY	GBP/USD
4Q high^	151.72	1.3875	1.0467	107.00	1.2077
	13 Nov 23	31 Oct 23	3 Oct 23	3 Oct 23	3 Oct 23
5 Jan 24	**144.63**	**1.3363**	**1.0943**	**102.41**	**1.2720**
3Q low^	138.05	1.3110	1.1236	99.77	1.3136
	13 Jul 23	13 Jul 23	17 Jul 23	13 Jul 23	13 Jul 23

*Implied by interest rate futures; ^USD's perspective
Sources: DBS Research, Bloomberg data (daily close)

Dallas Fed President Lorie Logan did not rule out a hike because financial conditions have eased and could reignite inflation if consumer demand improves. So, **pay attention to the US CPI data on 11 January**, which consensus sees rising to 3.2% YoY in December from 3.1% YoY in November. Core inflation remains high above the 2% target despite expectations for it to slow to 3.8% from 4.1%. Logan added that the Fed may need to slow down the pace of its balance sheet reduction, an issue discussed at the 12-13 December meeting.

However, the currency volatility around last Friday's stronger-than-expected US nonfarm payrolls suggested that **the Fed would not be alone in tempering rate cut expectations**. Between October and November, CPI inflation rose to 2.9% YoY from 2.4% in the Eurozone, held steady at 3.9% in Canada, and fell sharply to 3.9% from 4.6% in the UK. However, core inflation remained above the 2% target at 5.1% in the UK, 3.4% in the Eurozone, and 3.1% in Canada. Like the Fed, the European Central Bank will unlikely condone an early rate cut in March and six cuts this year. The same can be said about the Bank of Canada and the Bank of England regarding the four rate cuts that interest rate futures see starting this year in April and June, respectively.

Hence, we **cannot rule out the DXY and its components struggling against each other ahead of their central bank meetings**. EUR/USD could consolidate between 1.0870 and 1.10 this week. Having retraced only 25% of its November-December fall, USD/CAD could eye 1.35 if it pushes above its 1.3285-1.3400 range. GBP/USD held a 1.26-1.28 range since mid-December. Nonetheless, the urgency to dump the greenback has ebbed from the **10Y bond yields below their July lows in Canada, the Eurozone, and especially in the UK**.

Conversely, **Japan's New Year's Day earthquake have dampened expectations for an early end to the Bank of Japan's negative interest rate policy**. USD/JPY rebounded by 2.5% to 144.63 last week, its largest weekly gain since August 2022, with scope to push higher to 146.6-147.7 if tomorrow's Tokyo CPI inflation drops again in December.

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