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DBS

Macro Insights Weekly

US treasury supply and demand

Group Research

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- *US bond market has been remarkably volatile lately. In the last five weeks, yields have risen and fallen by nearly 50bps in each direction. Signs of unrest in the world's largest debt market?*
- *The demand/supply dynamic appears precarious.*
- *The Fed is cutting its treasuries holding, while the treasury is boosting issuances.*
- *But both US and international private sectors are eager buyers of US government debt.*
- *Both the nominal and real yields offered by short- and long-term US debt are attractive.*
- *Volatility notwithstanding, the US public sector debt remains well-bid.*

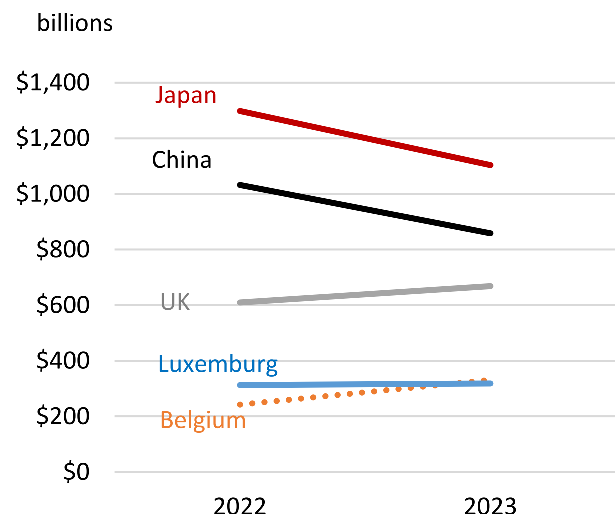
Key data release and events this week:

- *Anticipated slowdown in 3Q GDP for Japan and Malaysia*
- *Expected narrowing of Singapore's NODX decline in October*
- *The central banks in China and the Philippines are expected to maintain their current policies this week*

Chart of the Week: Holding of US treasuries

China and Japan have reduced their holdings of US treasuries lately, just as the US Federal reserve has shrunk its balance sheet. The trend is not all negative, with the holdings of UK and Belgium rising. But the key support for US treasuries is coming from the private sector. Both US and non-US private sectors' holding of progressively higher yielding US treasuries have gone up considerably over the past year. There may be a lot of treasuries in the supply pipeline, but demand is not anaemic either.

Top 5 foreign holders of US treasuries



Source: Fred database, DBS

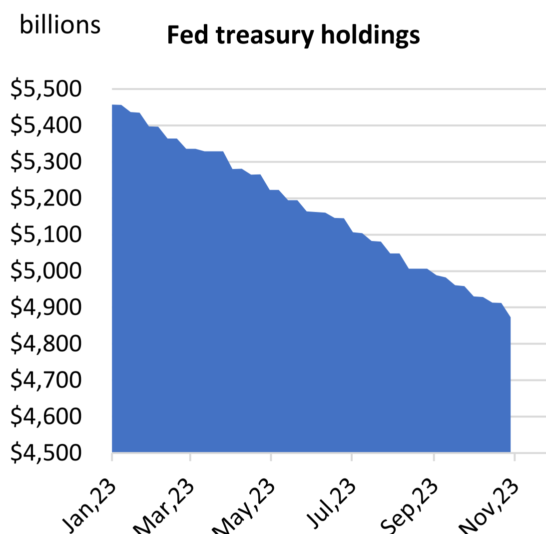
Refer to important disclosures at the end of this report.

Commentary: US treasury supply and demand

US 10-year bond yield has risen by 230bps since the beginning of last year, a sizeable increase by historical standards. Lately, the increase has also been accompanied by considerable volatility. Just in the last five weeks, yields have risen and fallen by nearly 50bps in each direction. Signs of worrisome unrest in the world's largest debt market?

The first and second reason for rates volatility are inter-related. US Federal Reserve's policy rate hikes and quantitative tightening programs have, over the past year and a half, caused monetary conditions to tighten, pushing up the entire yield curve. As the policy cycle matures and markets begin to price in, first an end of rate hikes, and then eventual rate cuts, some volatility in rates should be expected.

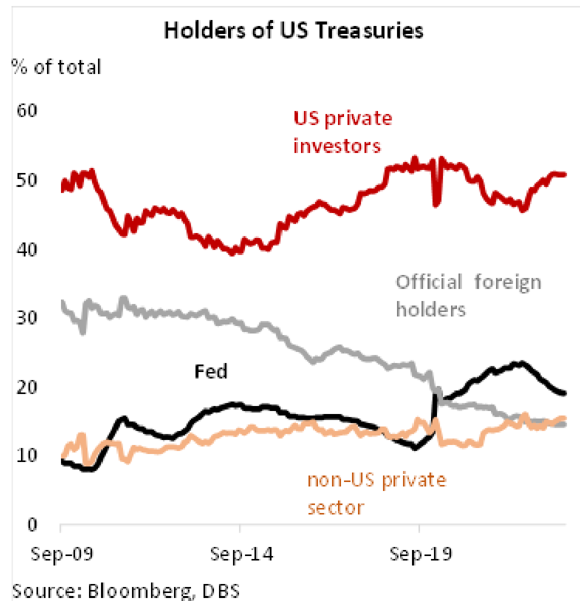
There is also the matter of bond supply/demand. US Fed is cutting its holding of treasuries, while the treasury's issuances are ballooning to finance a 15% jump in government debt/GDP ratio since 2020.



Source: Fred, DBS

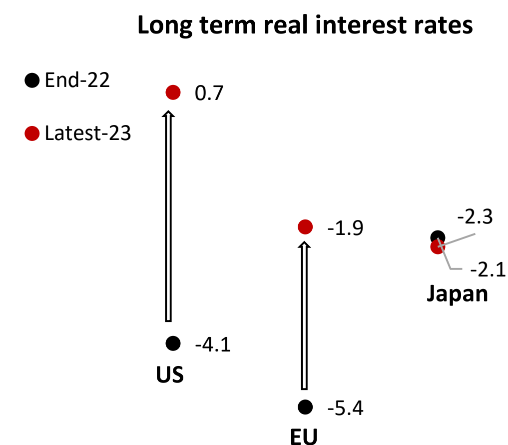
But even as the Fed has been reducing its holdings, the demand side has not faced any meaningful shortfall.

In fact, the key support for US treasuries is coming from the private sector. Both US and non-US private sectors' holding of progressively higher yielding US treasuries have gone up considerably over the past year.



Source: Bloomberg, DBS

Why is the private sector so keen? The answer is simple—attractive nominal and real yields. At 5.5% at the short-end and 4.5%+ at the long-end, US treasuries and the USD are attractive worldwide. Easing inflation has also boosted the real yield from the treasuries. The US public debt has no shortage of takers.



Source: DBS, CEIC. Long term rates calculated by taking the difference between 10-yr bond yield and average inflation for the year

Taimur Baig

Key forecasts for the week

Event	DBS	Previous
Nov 14 (Tue)		
US: CPI (Oct)	3.4% y/y	3.7% y/y
Nov 15 (Wed)		
Japan: GDP (3Q P)	0% q/q saar	4.8% q/q saar
China: 1Y MLF Rate	2.50%	2.50%
China: industrial production (Oct)	4.0% y/y	4.5% y/y
- retail sales	7.0% y/y	5.5% y/y
- fixed asset investment	3.1% y/y ytd	3.1% y/y ytd
Indonesia: exports (Oct)	-15.1% y/y	-16.2% y/y
- imports	-6% y/y	-12.5% y/y
- trade balance	USD3.0bn	USD3.42bn
Nov 16 (Thu)		
Japan: exports (Oct)	0.7% y/y	4.3% y/y
- imports	-16.3% y/y	-16.4% y/y
- trade balance	-JPY288.7bn	JPY72.1bn
BSP overnight borrowing rate	6.50%	6.50%
US: industrial production (Oct)	0.2% m/m sa	0.3% m/m sa
Nov 17 (Fri)		
Singapore: non-oil domestic exports (Oct)	-7.5% y/y	-13.2% y/y
Malaysia: GDP (3Q)	3.0% y/y	3.3% y/y

Central bank policy meetings

Philippines' BSP (Nov 16): The evolving inflation-growth-currency dynamics lower the need for a follow-up rate hike at the scheduled policy review this week. Since the BSP's intermeeting hike in late-Oct23, the incoming inflation outcome surprised on the downside, whilst 3Q GDP growth beat consensus to rise 5.9% yoy from 2Q's 4.3%. The US Fed's pause this month has also provided a breather to the Asian counterparts, though we reckon that the regional central banks will continue to monitor the US dollar and UST yield movements to gauge the impact on the domestic financial markets. While the urgency for the BSP to hike this month is low, we maintain our call for additional monetary tightening this quarter, subject to global developments.

People's Bank of China (Nov 15): The PBOC is expected to maintain the 1Y MLF rate at 2.50% this week, as the economy has shown some signs of stabilization. Although industrial production is projected to ease from 4.5% YoY in September to 4.0% in October due to weakening external demand, the performance of other sectors is improving. Retail sales are expected to have accelerated further from 5.5% YoY in September to 7.0% in October. Consumption sentiment was largely favorable during the Golden Week Holiday, with domestic tourist traffic and tourism revenue increasing by 4% and 2%, respectively, compared to 2019 levels. One of the e-commerce giants also reported record-high "Single-Day Gala" sales volumes. Meanwhile, property sales also showed relative stabilization in tier 1 cities, translating into a positive wealth effect. Fixed asset investment is expected to remain at 3.1% YoY YTD, with investments in strategic sectors such as infrastructure, EVs, and renewables offsetting the shortfall in property investment. That said, the PBOC is now waiting for the impact of recent stimulus to unfold before considering another round of rate cuts.

Forthcoming data releases

Japan: The preliminary estimate for 3Q GDP is scheduled for release this week. We expect a technical payback, bringing GDP growth to nearly 0% after the robust 4.8% QoQ saar expansion experienced in 2Q. Notably, consumption growth seems to have accelerated in 3Q, attributed to a buoyant stock market and a modest uptick in wage growth. The recovery trajectory of goods and services exports is evident, facilitated by a weakened yen, reinforced trade competitiveness, and an increase in tourist inflows. However, data signals a significant ongoing decline in investment, driven by subnormal capacity utilization and continued restraint on new capital expenditures. Our full-year GDP growth

forecast stands at 2.0%, with an expectation of a slower growth rate of 1.0% in 2024.

Malaysia: We expect Malaysia's 3Q23 final real GDP growth to come in at 3.0% YoY, lower than the advance estimate of 3.3%, and steady vs 2Q23's 2.9%. The export-oriented manufacturing sector remained in the doldrums, amid global external headwinds and an uncertain environment. The services sector, which accounts for ~60% of the economy, performed softer than advance estimates, even though growth remained resilient in 3Q23, supported by sturdy household spending and improving inbound tourism. Construction remained a bright spot, boosted by multi-year infrastructure projects.

Singapore: Singapore's non-oil domestic exports (NODX) year-on-year (YoY) fall likely narrowed for the second straight month to 7.5% in Oct vs Sep's fall of 13.2% YoY, in our view, even though the decline extended for the 13th consecutive month. Base effects became more favourable at the start of 4Q23. The improvement in new export orders of the manufacturing purchasing managers index (PMI) also signalled better days for overseas shipments, notwithstanding the still uncertain global economic climate. Sep's narrower contraction in electronics and non-electronics exports could have both extended into Oct, albeit at varying pace.

Economics Team

India: Inflation eases to a five-month low

India's October inflation rose by a slower 4.9% yoy vs 5% month before, helped by base effects and stabilising food prices.

Food price inflation was steady at 6.6% yoy, with vegetable prices up 3.4% MoM after two months of decline. Retail high frequency data had seen onion prices firm up in recent weeks, with its impact filtering through the food component, besides cereals, pulses, protein sources (eggs) and sugar. Weather disturbances resulted in a delay in harvest arrivals, stoking onion/ vegetable prices. The government has been swift in its response to rising onion prices, imposing export duties, setting minimum export prices, and offloading buffer stocks. The urgency is underscored by the fast-approaching festive period, as well as a busy election calendar.

Fuel inflation declined -0.4% YoY due to a high base last year when commodity prices were elevated, notwithstanding higher kerosene prices. Approaching elections and a correction in global oil prices lower the likelihood of an upward adjustment in retail pump prices. Core CPI inflation (ex-food and fuel) eased sharply to 4.2% yoy vs 4.5% month before.

The path ahead is likely to be dictated by food price trends influenced by weather conditions. Policymakers will nonetheless be comforted by subdued core readings, which reflects limited passthrough of the supply-side shocks. With onion prices quickening in early November and other vegetables bottoming out in midst of festive demand and supply shortages in few segments, the trend suggests inflation will return to 5% + level in November. Past cycles have shown that vegetables driven shocks prove to be short-lived, as supplies arrive in a couple of months. Stabilising global oil prices lowers one source of uncertainty for the time being.

The central bank will draw comfort from the persistent moderation in core pressures. Yet, policymakers will prefer to stay cautious on the outlook, expressing clear guidance that the committee sees 4% as the inflation target and will not be comforted by levels north of the target. Being mindful of the higher-for-longer narrative from the US Fed, the central bank's interventionist bent has led the USDINR volatility to tumble in recent months, with the recent 1M implied INR vols only a shade above the pegged USDHKD in the region, as cited by press. Market participants will be wary of breakout risks. On rates, tracking global yields, IN 10Y bond yield (generic) pulled back from highs this week, albeit lingering uncertainty over the timing of the RBI's OMO marked a floor, limiting recent moves to 7.25-7.35%. Despite an absence of outright OMOs, official data showed that the central bank was active in bond sales in the secondary market till last week.

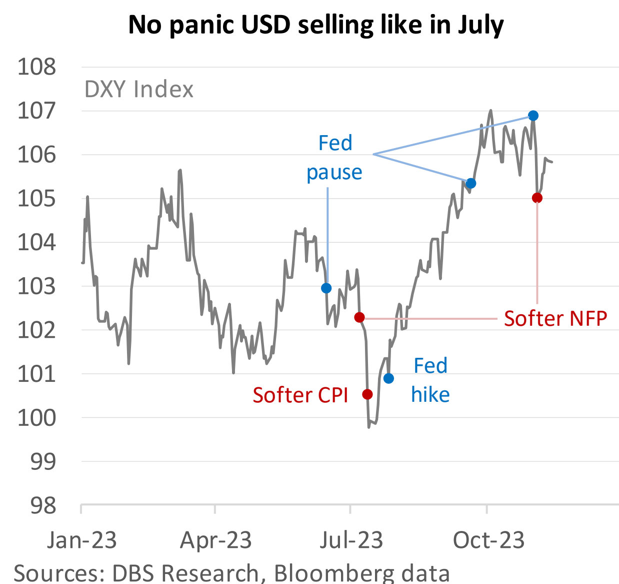
State elections are underway in five states, with results due on 3-Dec. This includes the key heartland states of Madhya Pradesh, Chhattisgarh, and Rajasthan, besides Mizoram in the north-east and Telangana in south. The past outcome of the state polls has had modest bearing on the results of the general elections (next scheduled for Apr-May24). Yet, market participants will focus on the Dec23 results to get colour on the popularity of the incumbent as well as the new opposition coalition.

Radhika Rao

FX: Navigating a complex terrain

The US dollar's sell-off on this month's lower US nonfarm payrolls could be another head fake, like the episode in early July. DXY recovered from 105 to 106 last week, near the level from which it fell. Back then, the Index DXY plunged to the year's low of 99.6 on 14 July, only to end at the year's high of 107.3 on 3 October. The Fed pushed back against the market's rate cut bets with a "higher for longer rates" narrative backed by a hike in July that propelled the US 10Y bond yield to 5%. The greenback also looked past Fitch's decision to remove the US' triple-A debt rating on 1 August over the federal debt ceiling crisis. The rating downgrade was eclipsed by a significant improvement in the US economic outlook, in contrast to the stagnation in the Eurozone and the UK economies.

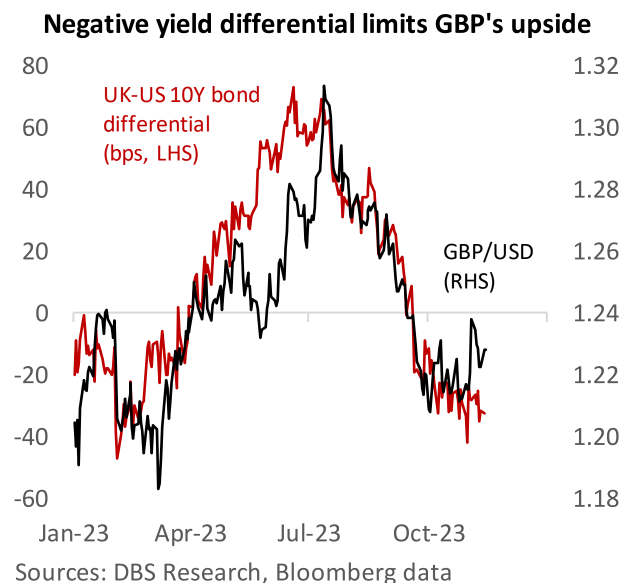
No panic USD selling like in July



Sources: DBS Research, Bloomberg data

Hence, **any USD depreciation from today's US CPI inflation** softening to 3.3% YoY (consensus) in October vs. 3.7% in September **could be reversed by tomorrow's accelerated decline in UK CPI inflation** to 4.7% (consensus) from 6.7% for the comparable periods. Although the US economy is unlikely to repeat its exceptional performance in 3Q23, the UK economy is bordering on recession. UK's GDP growth may have avoided negative growth in the third quarter, but domestic demand did not. The unemployment rate increased steadily to 4.3% in July from 3.7% in January. Hence, it was not a surprise that the Bank of England kept the bank rate unchanged at 5.25% for a second time on 2 November. We doubt that GBP/USD can keep diverging with the negative 10Y UK-US bond differential.

Negative yield differential limits GBP's upside



Sources: DBS Research, Bloomberg data

More importantly, Fed Chair Jerome **Powell and his colleagues** emphasized last week that inflation was too high above the 2% target to consider rate cuts. They also **kept the door open for another hike on 13 December** despite holding rates unchanged for two straight meetings. This point became evident and relevant after the Reserve Bank of Australia hiked by 25 bps to 4.35% on 7 November following four pauses. The European Central Bank also sees inflation staying firm in the coming months and has been pushing back against rate cut expectations. Finally, USD/JPY

is taking the Fed's hawkish stance seriously by staying near the year's high of 151.70.

Neither will markets read too much into Moody's lowering the outlook for the US' triple AAA debt rating to negative from stable last Friday. First, the US government will not default on its debt obligations because of the bipartisan agreement in early June to suspend the federal debt ceiling to January 2025. Second, Moody's decision could become a blessing in disguise if it motivates Republican and Democrat lawmakers towards some form of continuing resolution to avert a government shutdown by the 17 November deadline. In the event they don't, the greenback should stay offered as they did during the past three shutdowns. DXY also recovered after government offices reopened.

USD/CNY sideways with a downside bias

Sources: DBS Research, Bloomberg data

The Biden-Xi meeting at the APEC Summit on 15 November is looming large this week. Many countries hope the meeting will pave the way to continue and enhance the high-level dialogues initiated this summer aimed at stabilizing the increasingly strained relations between the world's two largest economies. **But will it be enough for USD/CNY to break below the 7.26-7.32 range** established on 8 September? Realistically, the complex relationship between the US and China has become too deeply entrenched in mutual distrust for both nations to deviate from their adversarial path of scepticism and rivalry. Xi will also meet US business leaders to reassure foreign investors to stay in China. Earlier this month, foreign direct investments in China turned negative for the first time since 1998 in 3Q23.

On a positive note, Chinese equities bottomed last month after Beijing allowed the budget deficit to widen to more than its stipulated 3% of GDP. However, it remains to be seen if China can reassure investors that the stimulus would be enough to shore up its economy. Last week, for October, the larger-than-expected decline in China's exports paled against South Korea's first export growth since September 2022. China's CPI inflation also turned negative for the second time this year in October.

In conclusion, currency markets continue to navigate a challenging and complex terrain. Apart from the divergent paths for interest rates promoted by the central banks and markets, monetary policies appear too aligned between central banks to repeat the USD sell-off from November 2022 to January 2023. Although the US economy will unlikely repeat its exceptional performance in 3Q23, other countries are not rushing to prove themselves stronger. Fluctuating data and geopolitical fragmentation have added to the volatility but not the momentum to push exchange rates out of their recent ranges.

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