Macro Insights Weekly

Fed and ECB's balance sheet headaches

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- *Despite steady QT, the balance sheets of ECB and Fed remain enormous (ECB: 50% of EU GDP, Fed: 30% of US GDP). More consolidation is in store, with uncertain implication for economies and markets.*
- *QE has had its helpful and distortionary impact, same holds for ongoing QT.*
- *Banks' deep dependence on reserves could be undermined by QT.*
- *Fiscal financing could be jeopardised.*
- *Asset price volatility could rise.*
- *QT needs to continue, but complications would arise next year as the economy slows.*

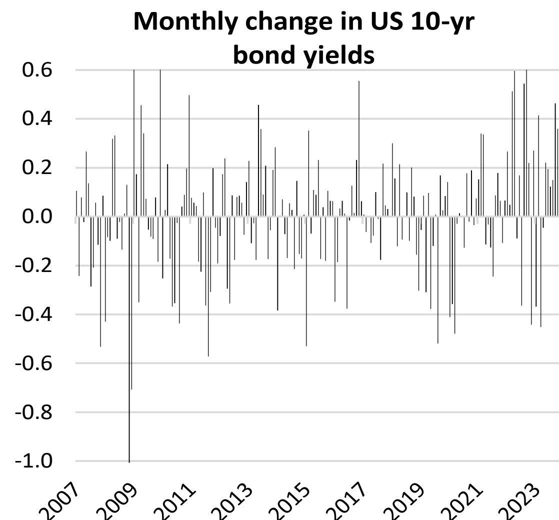
Key data release and events this week:

- *BI is likely to keep rates unchanged as inflation is likely to stay below 3%*
- *Japan's Oct CPI inflation is expected to rebound on higher food and energy prices.*
- *Singapore's headline inflation is set to rise but core inflation should remain steady.*

Chart of the Week: Spike in bond volatility

US 10-year bond, one of the largest traded financial instruments in the world, saw its yield rise by 46 and 36bps in September and October, respectively, while the yield has fallen by more than 50bps so far this month. This magnitude of up and down is rare by historical standards. The market has lurched from a "high-for-long" narrative to one built around "soft-landing," the latter in reaction to recent data points suggesting that both growth and inflation are cooling. From peak fear to goldilocks, the settling point next year may well be neither.

Monthly change in US 10-yr bond yields

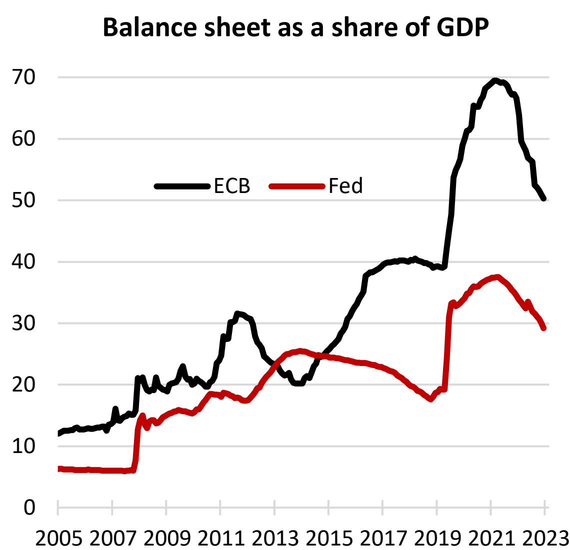


Source: Bloomberg, DBS

Commentary: Balance sheet headaches

Despite steady quantitative tightening, the balance sheets of the two largest central banks in the world remain enormous. After nearly a year and a half of QT, the Fed balance sheet stands at nearly USD8trln, which amounts to 30% of US GDP. The corresponding figure for the ECB is 50% of GDP, despite an accelerated QT program relative to that of the Fed.

Balance sheet as a share of GDP



Source: Bloomberg, DBS

Quantitative easing has become a key part of the monetary policy toolbox of major central banks in this century. It is clear that with their power to print money and purchase assets, central banks are capable of boosting asset prices, resolve liquidity crisis, and reduce deflation risks.

But bloated central bank balance sheets, built through purchasing financial assets and injecting bank reserves, come with their share of complications and costs. Research by BIS and Fed officials have shown that they lead to a financial system where banks are over-reliant on central banks for funding. That in turn could distort banks' incentives to manage liquidity and portfolio risks. QE has also been associated with exacerbating inequality, as such monetary operations favour those with significant ownership of financial assets and property, leaving the rest behind.

At the other end of the operational spectrum, shrinking the balance sheet, which in theory is welcome as it signals normalisation of economic conditions, comes with its share of risks. As rates rise, central banks take on capital losses on their holding of fixed income assets. Additionally, central banks stepping away from bond buying or holding while there are large fiscal funding needs could end up destabilising the government debt market. Case in point is the US, where there has been a marked rise in volatility in treasury markets, even as recent easing of long-term interest rates has given the markets some relief.

G2 central bank balance sheets need to continue to shrink for months and years as the level of balance sheet sufficient for the market's liquidity needs is several trillions lower, in our view. For the Fed, for instance, the current monthly rate of balance sheet reduction will take it from the present level of USD7.8trln to around USD6.5trln by the end of 2024, still more than ample by historical standards, necessitating further consolidation through 2025 and beyond.

But complications abound. If growth slows next year and rate cuts are warranted, could they continue alongside QT? That would require the Fed to differentiate between the impact of balance sheet operation from interest rate policy. Can QT continue if bond yields turn volatile or soar? These tough choices are ahead for the Fed and ECB.

Taimur Baig

Key forecasts for the week

Event	DBS	Previous
Nov 20 (Mon)		
China: 1Y loan prime rate	3.45%	3.45%
Thailand: GDP (3Q)	2.1% y/y	1.8% y/y
Malaysia: exports (Oct)	-4.0% y/y	-13.7% y/y
- imports	-9.0% y/y	-11.1% y/y
- trade balance	MYR23.4bn	MYR24.5bn
Taiwan: export orders (Oct)	-6.5% y/y	-15.6% y/y
Nov 21 (Tue)		
Hong Kong: CPI (Oct)	2.1% y/y	2.0% y/y
Nov 22 (Wed)		
Singapore: GDP (3Q, F)	0.8% y/y	0.7% y/y
Nov 23 (Thu)		
Singapore: CPI (Oct)	4.4% y/y	4.1% y/y
Indonesia: BI 7D reverse repo	6.00%	6.00%
Taiwan: industrial production (Oct)	-7.3% y/y	-6.7% y/y
Nov 24 (Fri)		
Japan: CPI (Oct)	3.4 % y/y	3.0% y/y
Malaysia: CPI (Oct)	1.8% y/y	1.9% y/y
Singapore: industrial production (Oct)	-4.8% y/y	-2.1% y/y

Central bank policy meetings

Indonesia's BI (Nov 23): Bank Indonesia is likely to keep rates unchanged this month. Rupiah stability was the driving factor behind the unexpected hike in October, and since then market pressures have eased with the US dollar and yields pulling back post the US Fed's pause. Capital management measures have also been introduced to boost the FX reserves stock, and in turn improve defences to backstop the currency. Besides a small miss in the 3Q GDP numbers, inflation has evolved along the central bank's predicted path and is likely to stay below 3% towards end-year. There are incipient pressures in few segments, especially food (led by rice), which are more likely to be addressed by supply-side measures rather than monetary policy.

People's Bank of China (Nov 20): The 1-year loan prime rate was kept at 3.45%, despite a faltering recovery. The PBOC may await the combined economic impact of existing support measures before considering more aggressive rate adjustments. The government has ramped up fiscal stimulus and the approved a RMB1 trillion special sovereign bond to bolster infrastructure and SOE investments. Reportedly, the authorities also plan to inject another RMB1 trillion of PSL to support the property market. After all, aggressive rate cuts will eventually add downward pressure on the CNY exchange rate.

Forthcoming data releases

Japan: CPI inflation for October will be released this week. Tokyo figures suggest a strong 0.5 ppt rebound in national CPI, reaching nearly 3.5% YoY in October, up from 3.0% in September. This upswing is primarily attributed to increases in fresh food and energy prices. With inflation consistently outpacing wage growth and real incomes on the decline, consumer spending power faces constraints. The preliminary estimate of 3Q GDP revealed a -2.1% QoQ saar contraction, falling below expectations. However, this contraction follows two quarters of 4% expansion in 1Q-2Q and does not signify a significant reversal in the overall growth trend. We continue to expect GDP growth to decelerate but remain in line with the trend rate from 4Q23 to 4Q24.

Malaysia: The themes of bottoming exports performance and contained inflation are likely to be reflected in Malaysia's Oct data. We expect Malaysia's goods exports to shrink for the eighth straight month by 4.0% YoY in Oct, but narrower than the double-digit declines over the past four months. Despite a still uncertain global economic environment, there are tentative signs that the global electronics slump has bottomed. Meanwhile, headline inflation has eased to 1.9% YoY in Sep – the lowest since early-2021 – and we expect it to hover slightly below 2% in Oct. The core inflation moderation likely stabilised, with

modest easing in food inflation and still negative energy contribution. We continue to see upside inflation risks from potential shocks to food prices from El Nino weather disruptions, currency depreciation, and most notably from recalibration of domestic subsidy policies.

Taiwan: October export orders and industrial production are in focus this week. Anticipated is a -6.5% YoY decline in export orders, an improvement compared to the double-digit declines observed in the preceding 11 months. Meanwhile, industrial production is expected to maintain a rate of -7.3%, in line with the -6.7% recorded in September. The dip in October exports to -4.5%, following a rebound to 3.4% in September, could be attributed in part to working day effects resulting from the National Day holiday. Our view remains unchanged, foreseeing a U-shaped recovery in electronics demand from 4Q onward, followed by inventory restocking in the first half of 2024.

Singapore: Regarding inflation, we expect the headline rate to rise for the second straight month to 4.4% YoY in Oct 2023. Headline inflation remained supported by higher private transport costs due to COE premiums, despite rather steady core inflation. Core inflation was likely steady at 3.0% in Oct, with stickiness seen especially in services items. The impact from favourable base effects has also largely run its course. The moderation in core inflation so far this year remains on track to reach the Monetary Authority of Singapore (MAS)'s end-2023 core inflation forecast target of 2.5-3.0%.

On industrial production (IP), the YoY decline likely extended for the 13th straight month, and widened to 4.8% YoY in Oct, vs Sep's 2.1% YoY drop, in our view. Electronics production, which accounts for over 40% of overall IP, likely exhibited volatility following Sep's 31.5% MoM sa surge.

Lastly, final 3Q23 GDP figures to be released mid-week will confirm the slight growth uptick. We expect overall real GDP growth to be revised up marginally to 0.8% YoY (1.1% QoQ sa), vs advance estimates of 0.7% YoY (1.0% QoQ sa), on better-than-expected manufacturing performance. The Ministry of Trade and Industry (MTI) would likely narrow its 2023 growth forecast range to the lower half of 0.5-1.5%, citing downside risks, while introducing its 2024 forecast range at 1-3%.

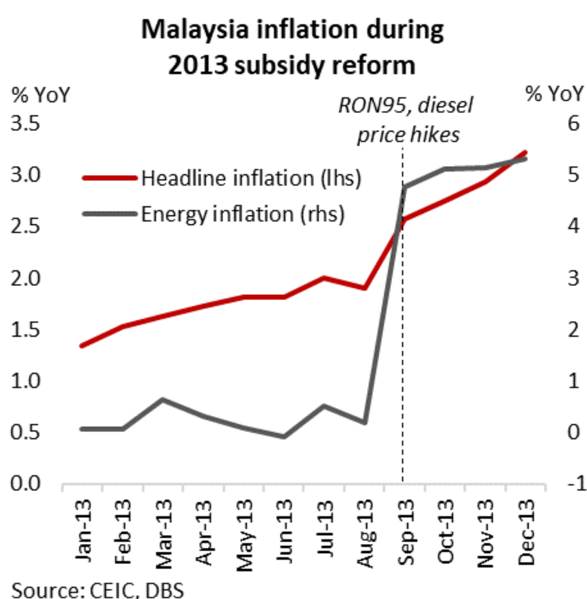
Thailand: Thailand's 3Q23 real GDP growth likely ticked slightly higher to 2.1% YoY, after 2Q23's disappointment of 1.8%. Robust private consumption, the ongoing return of foreign tourists, and improvements in net trade – smaller exports contraction and bigger imports decline – helped overall economic growth. That said, growth was contained by soft private investment and public spending. Overall, growth remained weak vs other ASEAN peers.

Hong Kong SAR: The CPI is expected to grow from 2.0% YoY in Sep to 2.1% in Oct. Despite incremental improvement in tourist arrivals and spending during the mid-Autumn/National Day holiday, the rising trend of HK residents' cross-border spending should keep consumer price at bay. Retail sales growth has slowed from 13.7% YoY in Aug to 13.0% YoY in Sep. On monetary front, the strong HKD has kept the import cost in check. After all, the HKD has strengthened against CNY, the major import origination of Hong Kong, by 5% YTD.

Economics Team

Malaysia: Higher 2024 inflation amid fiscal reforms; Fragile 2024 growth recovery

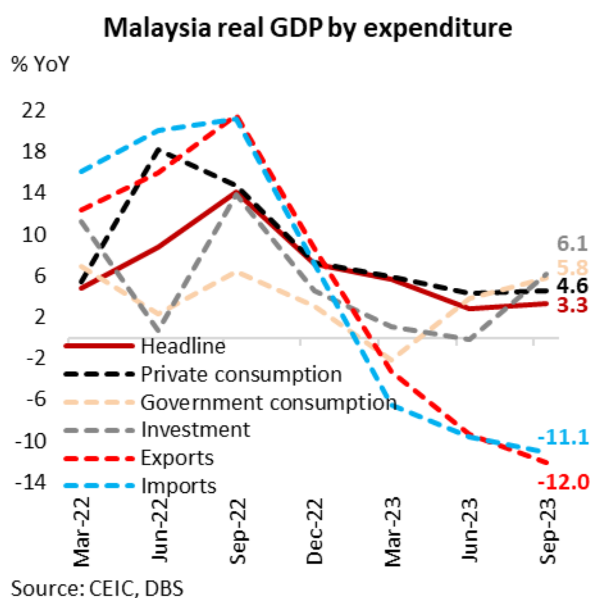
Malaysia's government intends to rationalise subsidies in 2024, according to its mid-Oct Budget 2024 announcement. The gradual implementation of subsidy rationalisation mainly on fuel and electricity, and planned service tax hike to 8% from 6% are likely to spur upside price pressures. **We are, therefore, raising our 2024 headline inflation forecast to 2.9%, from 2.5% previously, vs 2023's revised 2.5%.** Our updated 2024 inflation forecast is at the mid-point of the Ministry of Finance (MOF)'s wide 2.1%-3.6% projection range. We still see much price uncertainty, as details of the implementation timeline have yet to be released.



Source: CEIC, DBS

Government efforts to reduce fuel subsidies are positive for fiscal consolidation, but are likely to result in much higher prices. The subsidy reduction is set to be rolled out, despite the government's higher oil price assumption of USD85/bbl in 2024, vs 2023's USD80/bbl. Back in Sep 2013, when the prices of diesel and RON95 petrol were raised by 10% each, energy and headline inflation jumped to 4.8% YoY and 2.6% YoY, respectively, from 0.2% YoY and 1.9% YoY in Aug 2013. Inflation averaged at an elevated 3.0% rate in 4Q13. Inflation stayed high in 2014, averaging 3.1%, and diesel and RON95 subsidies were completely removed by end-2014, as global oil prices eventually tanked. The adjustment size and timing would determine the extent of inflation in 2024.

Regarding monetary policy, Bank Negara Malaysia (BNM) kept its overnight policy rate steady at 3.00% in 2013, but hiked by 25bps to 3.25% in July 2014. While high inflation was part of policymakers' considerations, robust growth of above 6% YoY in 1H14 was also a key factor.



Source: CEIC, DBS

Malaysia's 3Q23 growth rose slightly to 3.3% YoY but stayed weak, amid global external headwinds. We expect a fragile 2024 recovery, as exports pick up, but the global economic climate remains uncertain alongside lingering geopolitical risks. Another rate hike in 2024 is an upside risk, rather than our base case at this juncture.

Chua Han Teng

India: Risk weight hike for unsecured loans a prudent medium-term move

The RBI raised the risk weights on consumer credit exposure of commercial banks and non-bank financial companies by 25% late last week, underscoring its concerns over aggressive lending in this sector. At the October policy review, Governor Das had advised financial institutions to strengthen their internal surveillance to address build up in risks towards consumer credit.

Highlights of the new rules, include: a) for banks and non-banks, risk weights on consumer credit including personal loans, but excluding housing loans, education loans, vehicle loans and loans secured by gold and gold jewellery, will be raised by 25 percentage points to 125%; b) on credit card receivables, risk weights will rise by 25pp to 150% and 125% for banks and non-banks; c) additionally, bank lending to NBFCs will attract a higher risk weight by 25 percentage points (over and above the risk weight associated with the given external rating), excluding loans to housing finance companies of priority sector to non-banks.

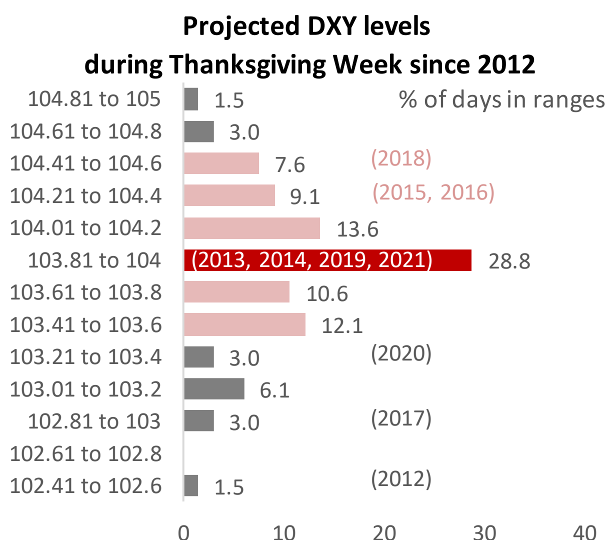
In the near-term, these rules will raise the capital requirement for banks (especially ones that hold lower Common Equity Tier 1) and in turn result in higher cost of capital. Selected non-bank counters slipped on Friday after this announcement. Banks might find it remunerative to lend to bigger non-bank institutions with stronger credit profiles, requiring the smaller players to seek other options including the capital markets. Non-banks face a double whammy as they not only face higher risk weights on their unsecured loan book but will also be subject to higher weights for banks' that lend to them. Credit to non-banks makes up about 33% of the banks' total service sector loans. The segment grew by an average 28% yoy this fiscal year, outpacing the pace of rise in overall service sector loans as well as credit to industries. Under personal loan category, credit for consumer durables have risen by an average 13% and credit card outstanding 31%. The share of bank borrowings as a source of total borrowings has risen sharply from 35.6% in Mar-20 to 41% in Mar23, according to the RBI's Financial Stability Report, revisiting concentration risks.

Considering the banks' exposure as well as non-banks in turn also lending towards these segments, risks magnifying any interim distress. We interpret these measures as a step to keep a check on discretionary and unsecured loans rather than real or asset-creating demand like housing, education, or vehicle loans. These restrictions are a prudent step by the central bank to prevent any fresh risk to the economy's banking sector as well as prevent a build-up in leverage amongst households.

Radhika Rao

FX: DXY gets a Thanksgiving reprieve; we are assessing the upside potential for JPY and CNY

Three developments led to the USD's worst weekly performance since mid-July. First, Fed hike worries cooled following the softer US nonfarm payrolls and inflation data. Next week's US PCE deflator should mirror the slowdown in CPI inflation to 3.2% YoY (0% MoM) in October from 3.7% YoY (0.4% MoM) in September. However, the FOMC Minutes on 22 November (Wed) should reiterate the Fed's desire for rates to stay restrictive into 2024 to promptly bring inflation back to its 2% target. **Second, fears of US-China relations spiralling out of control ebbed** after US President Joe Biden met Chinese President Xi Jinping at the APEC Summit in San Francisco last week. **Third, the US government averted a shutdown** on 17 November with a solid bipartisan stopgap spending bill into January-February 2024.

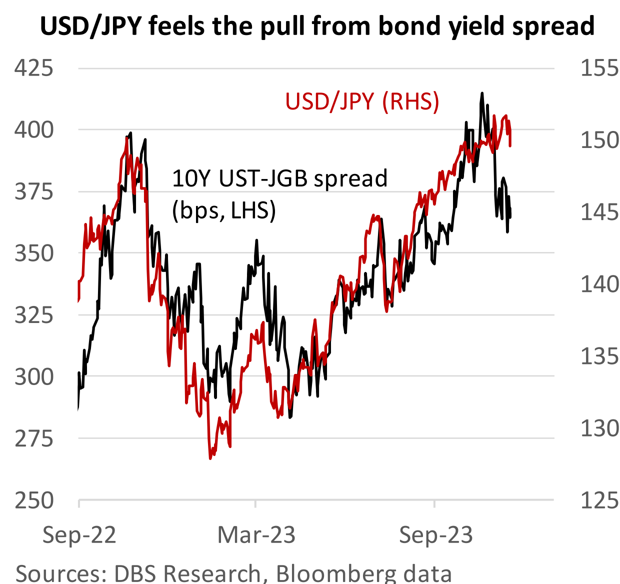


Although the stars appear aligned for more USD depreciation this week, this may not materialize. Having simulated the DXY's performances during the last Thanksgiving weeks since 2012, there is a two-thirds chance of the DXY holding above 103.5 or the previous year's closing level, and the DXY ending this week near last Friday's level of 103.9. The probability for the DXY to close this Friday higher at 104.4 or lower at 102.6 is exceptionally low at 1.5%.

GBP/USD should continue consolidating after the 1.8% spike to 1.25 last Tuesday. **The UK Autumn Statement on 22 November (Wed) will be significant.** Prime Minister Rishi Sunak fulfilled his pledge to reduce inflation by half this year. CPI inflation fell to 4.6% YoY in October from its 11.1% peak the same month a year ago. In turn, Chancellor of the Exchequer Jeremy Hunt is facing pressure to deliver fiscal measures to support the stagnant economy before the next general election, which is due by January 2025. However, the Bank of England projected inflation holding above 4% into March 2024, warning that market rates were too low to get inflation back to its 2% target. Hence, Hunt will likely resist trimming the income tax and lower the inheritance tax, the UK's most hated tax rate, instead. He could also provide relief to homebuyers to cushion the pressure on the property sector from high borrowing costs. A final decision will also be made on investment tax cuts to encourage business investments. Close attention will also be paid to the Office for Budget Responsibility's (OBR) outlook for the economy and public finances.

Expectations of a higher CPI inflation reading in Japan this Friday could extend USD/JPY's fall after its 1.3% decline to 149.63 last week. Consensus expects headline inflation to rise to 3.4% YoY in October from 3% in September, and excluding fresh food, to 3% from 2.8%. Bank of Japan Governor Kazuo Ueda affirmed that the yield curve control and negative interest rates may end when inflation is sustained at 2% from a positive wage-inflation cycle.

USD/JPY feels the pull from bond yield spread

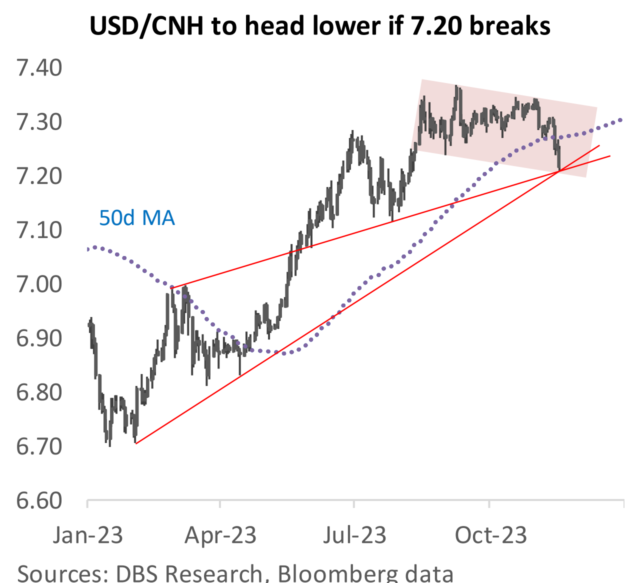


Sources: DBS Research, Bloomberg data

Last week, Japan's largest trade union, Rengo, intended to demand wage hikes of at least 5% in 2024. USD/JPY should be closer to 145 after the 10-year yield differential between US Treasuries and JGBs narrowed to 317 bps from 415 bps over the past month.

We are monitoring for downside risks in USD/CNH after it declined by 1.2% to 7.2173 last week. Apart from breaking beneath its three-month range between 7.24 and 7.37, USD/CNH is below its 50- and 100-day moving averages. However, to extend its downside, USD/CNH must still break below two trendline support levels and the floor of a descending price channel, all located near last Friday's close. **Hence, markets will probably be more receptive to upside surprises in Chinese economic data** for the final quarter of the year. However, China's economic data calendar is sparse this week. All said, we noted that CNH looked past China's negative manufacturing, trade, and inflation readings this month. Like most exchange rates elsewhere, USD/CNH fell with US long bond yields on softer US jobs and inflation prints.

USD/CNH to head lower if 7.20 breaks



Sources: DBS Research, Bloomberg data

Regarding US-China relations, many countries welcomed the Xi-Biden meeting at the APEC Summit as an essential step towards preventing the lingering mistrust between the two countries from escalating into a miscalculated and irreversible conflict. The desire to continue communication was reflected by the planned in-person meeting between US Commerce Secretary Gina Raimondo and her Chinese counterpart Wang Wentao in January 2024. Most countries and markets will want a follow-through in the X-Biden agreement to restore military-to-military dialogue on both sides. Biden said that US Secretary of Defense Lloyd Austin would meet his Chinese peer after China named a new defence minister to replace the previous one sacked four weeks ago.

Philip Wee

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