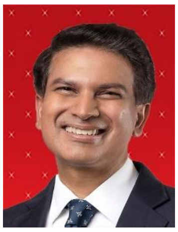
Macro Insights Weekly

FX storm brewing

Group Research

May 13, 2024



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- *Without much rise in volatility, global currencies have undergone large movements in recent years. Political pressure from the US could push up volatility.*
- *DM and Asian EM FX have corrected, on average, by 10-12% against the USD, since 2022.*
- *Most striking is the yen's 41% correction in two and a half years.*
- *There are some economic considerations for the Japanese authorities to push for a stronger yen.*
- *But we don't think they are compelling enough to push them toward vigorous intervention.*
- *US policymakers, convinced of USD's overvaluation, may push for action. Expect volatility.*

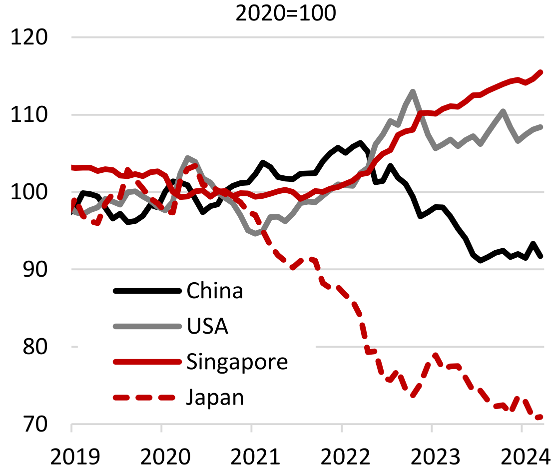
Key data release and events this week:

- *BSP should keep rates on hold amid a bump up in inflation*
- *PBOC is expected to keep the 1Y MLF rate unchanged amid stabilization in activity*
- *Japan's Q1 GDP could contract q/q amid a fall in consumption and exports*

Chart of the Week: Currency divergence

Sharp currency movements have characterised post-pandemic FX rates across the world. SGD and USD have appreciated considerably in real effective terms as the MAS and Fed tightened monetary policy to combat inflation. In contrast, China's real effective exchange rate has corrected by about 10% since 2020, reflecting weakening growth momentum and lower interest rates. The Japanese yen, down about 30% during this period, is a striking outlier, with rates still at their floor.

Real Effective Exchange Rate
2020=100

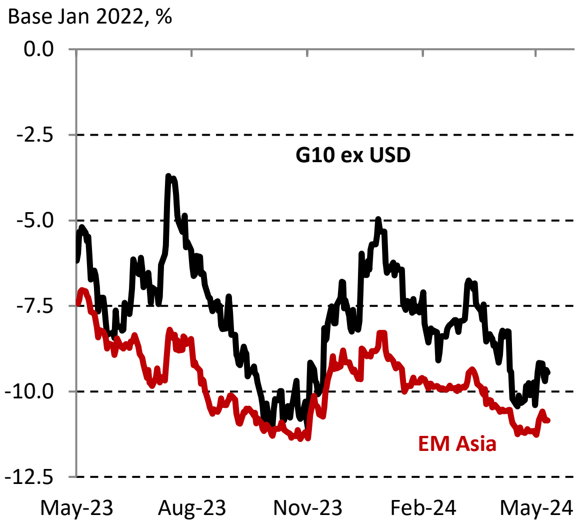


Source: BIS, DBS

Commentary: FX storm brewing

Without much rise in volatility, global currencies have undergone large movements in recent years. Sharp monetary policy tightening in the US in 2022/23, followed by what is increasingly evident to be a prolonged hold, has boosted the US dollar against just about all key currencies. We estimate that both DM and Asian EM currencies have corrected, on average, by 10-12% against the USD, since the beginning of 2022. There was a brief period of a rally by DM currencies against the USD in late 2023, but that has gotten reversed in recent months with curve steepening in the US and the entrenchment of the higher-for-longer narrative.

Currency Returns - EM Asia vs DM



Source: Bloomberg, DBS

No currency underscores the pressure stemming from US rate increases than the Japanese yen. In just two and a half years, the yen has depreciated by 41% against the USD, with the Bank of Japan still grappling with monetary policy normalisation.

The BoJ has some reasons to worry about keeping rates so low. Deflation is no longer an issue; in fact, inflation has pushed real wage growth to negative territory. The government's popularity has been hit by cost of living concerns, among other negative developments. We however don't think these matters are sufficient to push the government of Japan toward interest rate increases on an expedited manner or undertake vigorous FX intervention. We don't think the authorities are troubled by the prevailing positive growth/inflation mix.

If there is going to be a tipping point with exchange rates, it would be geopolitics related, in our view. The April 17 Japan-Korea-US ministerial statement, released in Washington DC, explicitly referred to the weakness of the won and yen a concern. Our reading of US treasury officials is that they view the USD to be over-valued against a wide range of currencies, including the Chinese yuan.

There is potential impact on the RMB that could transpire with sustained trade/tech salvos from the US. China's fledgling economy could buckle under new trade and tech restriction measures, compounded by the ongoing weakness of competitor currencies like the won and yen. A period of RMB weakness could ensue, which in turn could lead to even further measures from the US in a proverbial currency war.

Threats of tariffs or other trade restriction measures are likely to be the impetus for currency intervention in the period ahead, much more so than economic motivations, in our view. Global FX movements have been large lately, but not volatile; it won't take much for the latter to surface.

Taimur Baig

Key forecasts for the week

Event	DBS	Previous
May 13 (Mon)		
India: CPI inflation (Apr)	4.8% y/y	4.9% y/y
India: exports (Apr)	18% y/y	-0.7% y/y
- imports	16% y/y	6.0% y/y
- trade balance	-USD16bn	-USD15.6bn
May 15 (Wed)		
China: 1Y MLF Rate	2.50%	2.50%
Indonesia: exports (Apr)	9% y/y	-3.8% y/y
- imports	22% y/y	-12.8% y/y
- trade balance	$2.3bn	$4.5bn
US: CPI (Mar)	3.3% y/y	3.5% y/y
May 16 (Thu)		
Japan: GDP (1Q P)	-1.8% q/q saar	0.4% q/q saar
Philippines: BSP o/n rate	6.50%	6.50%
May 17 (Fri)		
Singapore: non-oil domestic exports (Mar)	-10.0% y/y	-20.7% y/y
Malaysia: GDP (1Q, F)	3.9% y/y	3.9% y/y

Central bank meetings

Bangko Sentral ng Pilipinas (BSP) (May 16): Philippines' domestic conditions as well as exogenous developments back a pause on rates rather than an imminent cut. March inflation rose to the higher end of the target on rice costs, apart from price adjustments, with Deputy Governor Dakila expecting a breach of 4% yoy in 2Q before falling back. Growth was relatively firm at 5.7% yoy, albeit missing expectations marginally. At the same time, peso remains under pressure on a steady USD (after the recent correction), keeping policymakers wary of imported price pressures. With markets pricing in a cut from the US Fed only late in the year, we expect the benchmark rate to stay high at 6.5%, more than a 15y high.

People's Bank of China (May 15): We anticipate that the PBoC will maintain the 1Y MLF rate unchanged at 2.50% this week, given some signs of stabilization observed in Labor Day Holiday tourism and export data. Authorities are currently monitoring the unfolding effects of recent stimulus measures before considering another round of rate cuts. Retail sales are projected to accelerate from 3.1% YoY in March to 4.0% in April. An improvement in consumer sentiment is evident through robust domestic tourist traffic and revenue during the Qingming and Labor Day holidays. Industrial production is anticipated to increase from 4.5% in March to 5.5% in April, aligning with a further uptick in sub-PMI production from 52.2 in March to 52.9 in April. Producer price edged down 0.2% on a monthly basis. Both external and domestic demand are also witnessing enhancement amid stronger than expected growth in exports and imports. On investment, fixed asset investment is expected to further rise from 4.5% YTD YoY in March to 4.6% in April, supported by government initiatives on equipment renewal in advanced manufacturing sectors. SOE investment continues to offset subdued investment in property development.

Forthcoming data releases

Japan: The preliminary estimate is likely to indicate a -1.8% QoQ saar contraction in GDP growth for 1Q, a decline from the 0.4% growth observed in 4Q23. Real exports experienced a contraction in 1Q, signaling persistent weakness in external demand, particularly in non-electronics sectors. Consumption indicators also saw a decline on a QoQ basis during the same period, attributed to inflation outpacing wage growth and the continual decrease in real wages. This downturn in 1Q GDP will impact the overall growth trajectory for the year. However, leading indicators such as PMI, production forecasts, and consumer confidence still indicate a potential rebound in growth starting from 2Q onward.

Malaysia: Malaysia's upcoming 1Q24 GDP release will likely confirm a growth recovery, as shown previously in the advance estimates. We expect 1Q24 real GDP growth of 3.9% YoY, vs 4Q23's 3.0% YoY increment. 1Q24's growth improvement was driven by a manufacturing rebound, as well as quicker mining, construction and services expansion. The growth uptick is likely to gather momentum over the course of 2024. This will be supported by the turnaround in the global trade cycle, which would benefit Malaysia's export-oriented manufacturing sector, alongside resilience in the construction and services sectors.

Singapore: We expect Singapore's non-oil domestic exports (NODX) decline to narrow to 10.0% YoY in April 2024, from March 2024's sharp 20.7% YoY drop. Sequential MoM seasonally adjusted overseas shipments likely rebounded in April 2024 after shrinking in February and March 2024. Forward-looking indicators such as the expansion in the new export orders sub-indices within the headline manufacturing and electronics manufacturing purchasing managers' indices (PMI) suggest improving demand and better days ahead for NODX. Yet, the exports recovery remains fragile, with downside risks for instance from lingering geopolitical tensions that could disrupt supply chains.

India/ Indonesia: India's inflation in Apr likely eased to 4.8% yoy from 4.9% in Mar as firmer food costs were offset from reductions in domestic fuel prices. Core is also expected to be benign at 3.1% in the month. Trade numbers will likely see the goods trade deficit steady at \$16bn, with base effects propping up export and import growth. Indonesia's trade balance in Apr, in the meantime, is expected to narrow from the Lebaran-driven spike to above \$4bn surplus in Mar. Our forecast is at a narrower ~\$2bn as commodity prices consolidate.

Economics Team

FX: Shifting trajectories in USD and the European currencies

The DXY Index should oscillate between 104.7 and 105.7 with a potential downside bias. Recent shifts in the economic trajectories of the US, Eurozone, and the UK are central to this analysis. During the first quarter of 2024, US GDP growth diminished significantly to its lowest point since the technical recession in 1H22. In contrast, the Eurozone and UK economies have emerged from their respective technical recessions in 2H23. On May 15, the EU Commission will reflect its confidence in the recovery by revising up its 2024 GDP growth forecast. Following its previous downward revision in February to 0.8% from 1.2%, EU GDP growth rebounded to 0.3% QoQ sa in 1Q24 from minus 0.1% in 4Q23. On Tuesday, another rise in May's ZEW Economic Sentiment Survey should validate this recovery extending into 2Q24.

However, the US Federal Reserve is less confident than the European Central Bank and the Bank of England regarding inflation returning close to the 2% target. On May 14, Fed Chair Jerome Powell and ECB member Klaas Knot will likely affirm the ECB lowering interest rates before the Fed. While the ECB will not pre-commit to more rate cuts beyond June, the markets anticipated the ECB and Fed to align rate cuts in September and December. Nonetheless, EUR/USD will eye the **US CPI data on May 15, hoping for disappointment to push above 1.0790** or its 100-day moving average.

However, the consensus is no longer looking for US inflation to slow, following last Friday's increase in the University of Michigan's 1Y inflation expectations to 3.5% in April from 3.2% in March. Instead, consensus sees CPI inflation holding steady at 0.4% MoM in April for a third month. However, CPI core inflation is seen slowing to 0.3% after three months of 0.4% readings. On May 15, consensus expects US advance retail sales growth to slow to 0.4% MoM in April from 0.7% in March, reflecting conservative consumer behaviour. On May 16, the DXY could mirror last Thursday's fall if US initial jobless claims increase again to highs not seen since August-September 2023.

The markets have also positioned for rate cuts by the BOE and the Swiss National Bank in June. After the surprise increase in Swiss CPI inflation to 1.4% YoY in April from 1% in March, the market sees the SNB on hold after delivering a second 25 bps rate cut to 1.50% on June 20. **USD/CHF fell into a lower 0.90-0.91 range after failing to trade above 0.92 at the start of May.**

Over the past month, GBP/USD traded in a lower 1.23-1.26 range on a dovish BOE. On May 9, the BOE voted 7-2 to keep the bank rate unchanged at 5.25%. Deputy Governor Dave Ramsden joined the most dovish committee member, Swati Dhingra, in advocating a rate cut. Governor Andrew Bailey indicated a rate cut is possible in June, contingent on the next two CPI inflation data nearing the 2% target. Hence, on May 22, April's CPI inflation needs to decelerate from the 0.6% MoM pace of the previous two months. Although UK GDP growth rebounded to 0.6% QoQ sa in 1Q24, the BOE observed a quicker dissipating of second-round inflation, potentially allowing for a less restrictive monetary policy. Bailey emphasized that there should be no pre-conception about how fast or far the BOE will lower rates.

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Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations)

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