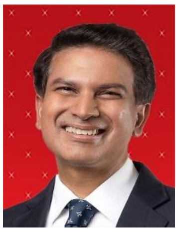
Macro Insights Weekly
Slowdown cometh?

Group Research

August 5, 2024



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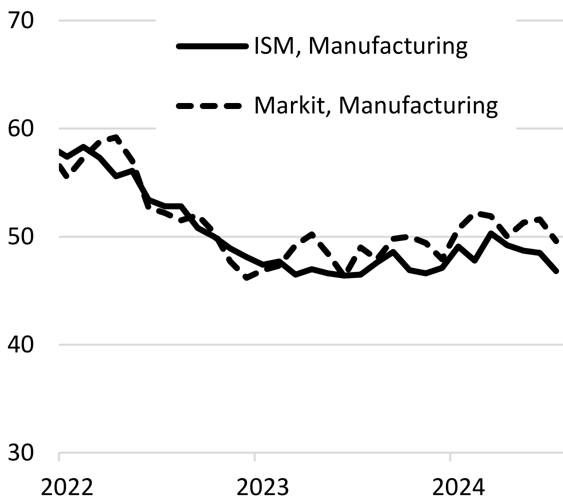
- *Markets are becoming concerned that a cyclical slowdown could be around the corner. This is particularly the case for the world's largest economy. But we don't see makings of hard landing.*
- *Granted, there are several corners of incipient weakness in the US economy.*
- *Signals from hiring, retail sales, and PMI are negative.*
- *Sharp curve steepening and equity market selloff are harbingers for slowdown ahead.*
- *It is crucial to maintain perspective. GDP, trade, and labour force figures are not alarming.*
- *We are not joining the herd in pricing in 75-100 bps in rate cuts in 2H24. 50bps would be adequate.*

Chart of the Week: Weak US PMI

Fed Chair Powell's constructive comments about the US economy in the middle of last week were challenged the very next day by the July survey of manufacturers (ISM). What Chair Powell sees as normalisation of jobs and inflation to pre-pandemic times could well be right, but several months of sub-50 ISM manufacturing PMI, along with services also in contraction territory, suggest rising levels of concerns about a softening orderbook. This is how economic slowdown compounds.

Purchasing Managers' Survey



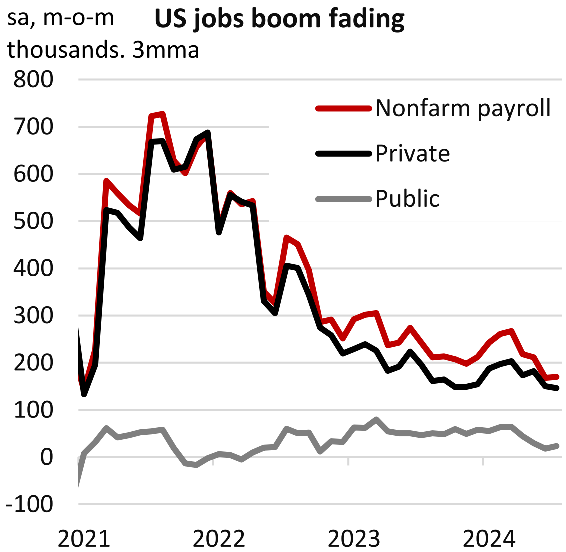
Source: CEIC, DBS. Data through July 2024

Commentary: Slowdown cometh?

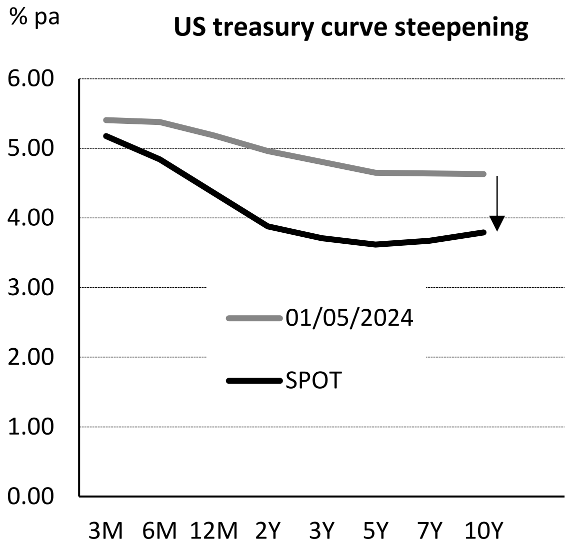
As far as cycles go, this is not a particularly lengthy one. It has only been three years since Western economies began their process of normalisation after the 2020/21 pandemic. For Asia, the period since the end of the pandemic is even shorter. But markets are becoming concerned that a cyclical slowdown could be around the corner. This is particularly the case for the world's largest economy.

Recent US data flow is not exactly alarming, but there are several corners of incipient weakness. The labour market (unemployment has risen to 4.3%; it was 3.7% at the beginning of the year), retail sales (less than 2%yoy growth through 1H24), and PMI (see chart of the week) are now softening without much ambiguity. The plethora of such data was compounded by the latest nonfarm payroll data late last week, which made the markets particularly nervous. The clearest reflection of that was the volatility marker VIX, which ended the week with the highest reading since March 2023. The fixed income market, meanwhile, has seen 84bps of steepening at the long end (10-yr) since May.

Rate cut expectations typically buoy the equity markets, but that has not been the case lately for two reasons. First, the markets have been in frothy territory for a while, with the S&P500's yield gap (treasury yield minus dividends) at comparable levels to the pre-GFC period. Those with substantial capital gains would be trigger-happy to sell at this juncture. Second, an anxiety permeating through the market is that the Federal Reserve, waiting till September to cut for the first time, may turn out to be too late to ensure a soft landing. As a result, we are witnessing the juxtaposition of fixed income rally and equity correction.



Source: CEIC, DBS



Source: Bloomberg, DBS

It is crucial to maintain perspective. 2Q US GDP surprised on the upside just a few days ago. Rising unemployment rate is largely a function of an expansion of the labour force, with many Americans returning to the work force. Looking at Asia's data, July has the making of a good month, with South Korea and Vietnam's exports up comfortably, in double-digit terms, year-on-year. We are therefore not joining the herd in pricing in 75, or even 100, bps in rate cuts. 50bps would be adequate, in our view.

Taimur Baig

FX: USD's outlook turned dovish

We have lowered our forecast for the USD across all currencies. The moment we had waited for this year arrived last week. At the FOMC meeting on July 31, Fed Chair Jerome Powell reckoned an interest rate cut was "on the table" in September. In the previous meeting on June 12, Powell said the Fed was ready to respond if jobs weakened unexpectedly and considered the rise in the US unemployment rate as an important statistic. Last Friday, the jobless rate increased to 4.3% in July from 4.1% in June, above the Fed's longer-run projection of 4.2%.

We expect more volatility from the market and the Fed perception gap. The futures market has priced in 125 bps of Fed cuts for the remaining three FOMC meetings of this year, including 50 bps reductions in September and December. The US Treasury 10Y bond yield plunged 404 bps to 3.79%, near the low at the end of 2023 when markets discounted seven cuts. After the jobs data triggered US recession fears, the S&P 500 index gapped below the critical 5400 support level. The expectations index in the US consumer confidence index held below 80 for six months, the threshold that usually flagged a recession ahead.

Fed officials will likely push back against criticism that it waited too long to lower rates. Echoing Fed Presidents Austan Goolsbee (Chicago) and Thomas Barkin (Richmond), Mary **Daly** (San Francisco) **should warn against overreacting to one month's data today**. The Fed will get the PCE deflator data on August 30, two more months of CPI inflation data on August 14 and September 11, and another monthly jobs report on September 6 before its decision at the FOMC meeting on September 18. During the post-FOMC press conference, **Powell said the economy was cooling and the odds of a hard landing were low**. Advance GDP growth rose to an annualized 2.8% QoQ saar in 2Q24 vs. 1.4% in 1Q24 on better personal consumption growth of 2.3% from 1.5%. Today, consensus expects the ISM Services Index to rebound to 51 in July after the decline to 48.8 in June. Hence, the Fed's Symposium on "Reassessing the Effectiveness and Transmission of Monetary Policy" on August 22-24 has become a significant event.

AUD/JPY remains vulnerable despite wiping out the year's gains last week. AUD/JPY depreciated 5.2% to 95.4 last week, below the 96.1 level at the end of 2023. The sell-off that started on the slower-than-expected US CPI inflation on July 11 was fuelled by a disappointing Chinese economy pressurizing commodity prices, a more resolute Bank of Japan in normalizing monetary policy, the Fed flagging a potential rate cut in September, the Kishida Cabinet's desire to arrest the yen's decline hurting its approval ratings, and Trump decrying the yen's massive weakness.

AUD bears will pay close attention to the Reserve Bank of Australia meeting on August 6 to see how aggressively the central bank pushes back against the November or December rate cut discounted in the future market. Although Australia's trimmed mean CPI inflation fell to 4.1% YoY in June from 4.4% in May, it remained above the 2-3% target. Pay attention to the Statement on Monetary Policy to see if the RBA brings forward the timeline for inflation to reach the 2-3% target from 2H25 and the 2.5% midpoint in 2026.

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