Macro Insights Weekly

Credit rally amidst monetary tightening

Group Research

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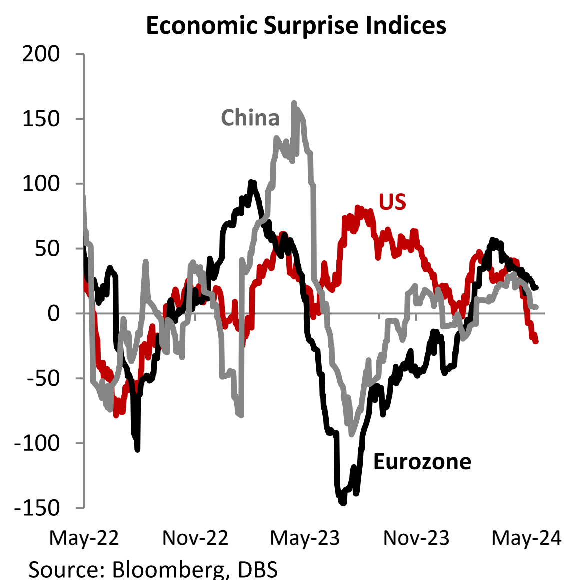
- *Global credit markets continue to rally, defying a repricing of the timing and depth of monetary easing. Short of an inflation rebound-driven selloff, the rally could have legs.*
- *The rally is underpinned by still-ample liquidity in the financial system.*
- *Spread compression notwithstanding, credit yields are attractive in absolute terms.*
- *Constructive credit sentiment is also centred around expectations of forthcoming disinflation.*
- *Beyond the US, Asian credit has gained in value in virtually all sectors.*
- *China's growth supportive measures could keep the rally going.*

Key data release and events this week:

- *Bank Indonesia and the Bank of Korea are expected to keep rates unchanged.*
- *Singapore's April data will indicate a slight easing in CPI inflation and a rebound in industrial production.*
- *Thailand's GDP growth for 1Q could mark the lowest point of the year.*

Chart of the Week: Cooling activities

Global growth momentum has sapped a tad. While the US economy is still looking strong overall, there are marginal signs of weakness, ranging from ISM orders to retail sales. The data from China are mixed, with cooling exports and retail sales on one hand and improving labour market on the other hand. Europe has seen soft factory orders and construction, but services remain strong. Not quite recession watch, but weaknesses are surfacing.

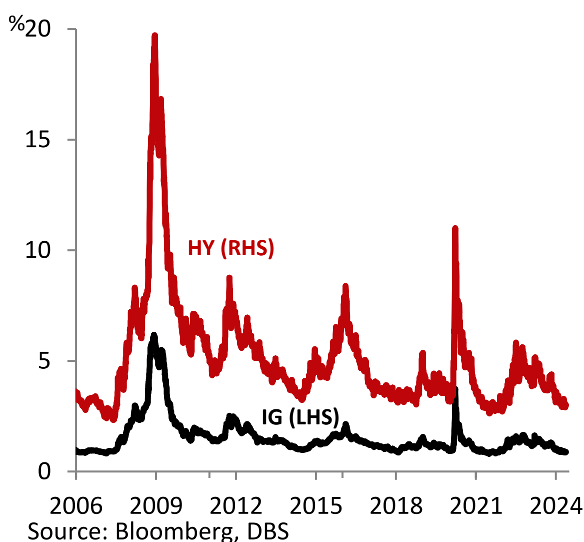


Source: Bloomberg, DBS

Commentary: Credit rally amidst tightening

A remarkable rally in global credit markets continues, defying a substantial repricing of the timing and depth of monetary policy easing in the near term. After this year's rally, investment grade and high yield USD credit are rich by historical standards, just when one would expect worries about the higher-for-longer narrative weighing on credit risk pricing.

Credit Spreads - US Corporate



Source: Bloomberg, DBS

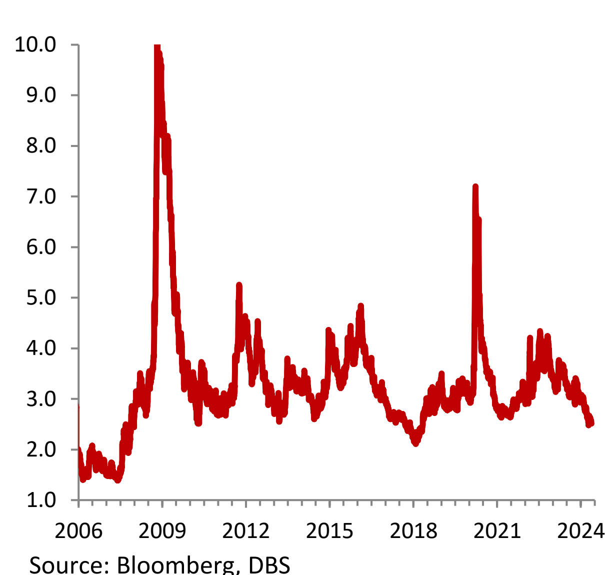
There are good reasons for buoyant sentiments. Despite higher rates and QT, central banks' provision for liquidity is still ample, with the combined balance sheets of the Fed, ECB, BoE, and BoJ still larger (both in nominal terms and as a share of GDP) than pre-pandemic peaks. Also, while the spreads look rich, they are priced from 5.5% short-term rates, meaning credit yields are attractive in absolute terms. Credit investors may find the spreads narrow, but they have not enjoyed such high returns in decades.

An additional, and critical, conviction is lingering; it is centred around rate cuts. The view is when they come, they would likely be a function of inflation easing toward the Fed's target, as opposed to a reaction to recessionary developments.

Good times for credit extend beyond the US. EM credit has rallied robustly across geographies and sectors. Here in Asia, except for Hong Kong, key markets followed by us are looking highly constructive. Even China, where the macro narrative has been challenging for long, spreads have been narrowing, from financials to industrials, from utilities to energy. The beleaguered real estate sector remains stressed, but one should not ignore its 140bps rally since November 2023. A series of supporting policy measures are helping.

Beyond China, India credit has seen robust rally in all six key sectors we track; same with Indonesia. Korea looks good mostly, except for its real estate and REITs sector.

Credit Spreads - Emerging Markets USD



Source: Bloomberg, DBS

Can the good times last? Only if inflation doesn't rebound, in our view. A couple of negative inflation surprises could stall and even reverse the historic rally in the credit space. Short of that, credit investors can continue to appreciate a rich and well rewarding market.

Taimur Baig

Key forecasts for the week

Event	DBS	Previous
May 20 (Mon)		
China: 1Y loan prime rate	3.45%	3.45%
Thailand: GDP (1Q)	0.8% y/y	1.7% y/y
Malaysia: exports (Apr)	19.0% y/y	-0.8% y/y
- imports	23.0% y/y	12.5% y/y
- trade balance	MYR11.4bn	MYR12.8bn
Taiwan: export orders (Apr)	7.0% y/y	1.2% y/y
May 22 (Wed)		
Japan: exports (Apr)	10.5% y/y	7.3% y/y
- imports	6.2% y/y	-5.1% y/y
- trade balance	-JPY103bn	JPY387bn
Indonesia: BI rate	6.25%	6.25%
May 23 (Thu)		
Singapore: GDP (1Q F)	2.3% y/y	2.7% y/y
- CPI (Apr)	2.6% y/y	2.7% y/y
Taiwan: industrial production (Apr)	11.5% y/y	4.0% y/y
Hong Kong: CPI (Apr)	1.8% y/y	2.0% y/y
South Korea: BOK base rate	3.50%	3.50%
May 24 (Fri)		
Japan: CPI (Apr)	2.3% y/y	2.7% y/y
Malaysia: CPI (Apr)	1.9% y/y	1.8% y/y
Singapore: industrial production (Apr)	-0.5% y/y	-9.2% y/y

Central bank meetings

People's Bank of China (20 May): Following the pause of 1Y MLF rate last week, the 1Y LPR was kept unchanged at 3.45% this morning. The PBOC is waiting for the combined economic impact of recent stimulus before implementing another round of rate cut. Last Friday, Beijing started issuing the CNY1trn ultra-long special bond to support infrastructure investment. Also, the authorities cut the downpayment ratio and mortgage rate for the first and second home. Hopefully, these could rescue the property market correction. As the Fed is delaying its first cut, a pre-emptive cut will add depreciation pressure on CNY exchange rates and trigger capital outflow.

Bank Indonesia (22 May): Recent developments are likely to leave the BI in a comfortable position to extend a pause on the rates front. 1Q24 GDP growth was firm at 5.1% yoy, benefiting from pre-election and campaign spending. Inflation has stabilised around the 3% mark within the BI target, while a broad dollar pullback has helped trim the YTD weakness in the rupiah to -3.3% from over 5% before. Yet, there is uncertainty regarding whether and when the US Fed will lower rates this year, underscoring the need to maintain favourable rate differentials. A favourable mix of domestic developments and a stable rupiah lowers the need to tighten policy further, providing the headroom to monitor global cues.

Bank of Korea (22 May): The Bank of Korea is expected to maintain the benchmark repo rate at 3.50% during this meeting. The governor indicated earlier this month the necessity to review the timing of rate reductions, pointing to the recent depreciation of the KRW and the robust 1Q GDP recovery. This implies a probable delay in rate cuts until later in the year. Our analysis indicates that the KRW and CPI inflation lack significant correlation. We remain confident that CPI inflation will continue to moderate to around 2.5% YoY in 3Q-4Q, offering leeway for the BOK to implement rate cuts within the year.

Reserve Bank of New Zealand (22 May): We see the monetary policy committee reaching a unanimous decision to keep the official cash rate unchanged at 5.50%. Despite falling to 4% YoY in 1Q24 from 4.7% in the previous quarter, CPI inflation remained above the official 1-3% target. However, a recent RBNZ business survey showed progress in inflation expectations becoming less elevated. One-year expectations fell to 2.73% in 1Q24 from 3.22% in the previous quarter, 2-year declined to 2.33% from 2.5%, and 5-year was unchanged at 2.25%. With inflation and inflation expectations above the 2% mid-point of target range, the bank should stay committed to keeping rates elevated for a sustained period with a more neutral than hawkish bias.

Forthcoming data releases

Japan: CPI is expected to decelerate moderately to 2.3% YoY in April from 2.8% in March. Tokyo CPI figures for April exhibited a significant slowdown to 1.8% from 2.6% in March, which was exaggerated by education subsidies. We project a moderate slowdown in national CPI to approximately 2% YoY in 2Q-3Q, followed by a rebound to over 2% starting from December. This projection factors in the impact of the recent yen depreciation, which is expected to boost CPI with a 9-month lag. Accordingly, we think the Bank of Japan will hike rates in 4Q at the soonest, from 0.1% to 0.25%.

Taiwan: April export orders and industrial production data will be released this week. Our forecasts suggest a moderate 7% YoY increase in export orders, and about 10% YoY increase in industrial production. There were some supply-side disruptions triggered by the Hualien earthquake. Earlier released April export figures showed a smaller-than-expected rise of 4.3% YoY. That said, the earthquake's impact appears temporary, rising overseas demand is poised to drive up both exports and output in the forthcoming months. As a leading indicator, manufacturing PMI ticked up to 50.2 in April, marking the first positive reading in two years and signaling a potential turnaround in the manufacturing sector.

Malaysia: We expect Malaysia's goods exports to rebound strongly to 19.0% YoY expansion in April 2024 from the previous two months' declines. April 2024's return to growth was likely driven by favourable base effects and improving external demand. Improving external demand was seen from Malaysia's April 2024 manufacturing purchasing managers index release, which showed a renewed expansion in new export sales, with the strongest growth rate in three years. 1Q24 real GDP growth picked up to 4.2% YoY from 4Q23's 2.9% YoY, and the ongoing exports upturn is one of the factors supporting our 4.8% real GDP growth forecast for 2024.

March 2024's headline inflation of 1.8% YoY was steady vs February 2024's print, and we expect a moderate 1.9% YoY reading in April 2024, amid stable demand and contained cost pressures. The anticipated shift to targeted subsidies continues to pose the biggest upside inflation risk, and we will continue to watch out for details regarding the policy shift.

Singapore: April 2024's data releases are likely to show CPI inflation easing slightly and industrial production (IP) rebound. We expect core inflation to cool slightly to 3.0% YoY in April 2024 vs March 2024's 3.1% YoY. The scheduled increase in water prices in April 2024 was one factor preventing a meaningful easing, despite contained imported price pressures and moderating domestic labour cost pass-through. Factoring in core dynamics and relatively steady YoY accommodation and private transport price increments vs the previous month, we expect headline inflation of 2.6% YoY in April 2024 vs March 2024's 2.7% YoY.

IP's contraction likely narrowed to 0.5% YoY in April 2024 from March 2024's sharp 9.2% YoY plunge, which mirrored the non-oil domestic exports trend over the same period. The Economic Development Board's recent manufacturing business expectations survey continues to point to better factory prospects in 2024 vs 2023's doldrums. The survey showed that Singapore's manufacturers expect higher output in 2Q24 vs 1Q24. They also anticipate

favourable business situation for the six months period April to September 2024.

On 1Q24 real GDP growth, we anticipate a downward revision to 2.3% YoY (-0.3% QoQ) from the advance estimate of 2.7% YoY (0.1% QoQ). This was primarily due to March 2024's weaker-than-expected manufacturing activity, which resulted in 1.8% YoY contraction in 1Q24, vs 0.8% growth envisaged earlier.

Thailand: Thailand's 1Q24 growth likely slowed to 0.8% YoY, from 4Q23's 1.7% YoY, but could mark 2024's low, in our view. Public spending and net trade were the key growth drags in 1Q24, amid the delayed approval of the FY2024 budget and fragile goods exports recovery but look set to improve over the coming months. Foreign tourism remained as a crucial growth engine in 1Q24, and we expect this trend to stay intact for the rest of 2024. Private consumption also contributed positively to headline growth, albeit smaller than in previous quarters.

Hong Kong SAR: Consumer price growth is expected to slightly slow from 2.0% YoY in March to 1.8% in April. The strong HKD continues to limit the spending power of tourists and encourages local residents to travel overseas instead. In April, the daily average of mainland tourist arrivals remained 37.1% lower than the 2018-19 full-year average, while the number of local residents departing stayed above this average. Rental costs also showed signs of slowing down. The average rental yield dropped from 2.7% in February to 2.68% in March. Along with the rising jobless rate, lowered labour costs added downward pressure on rental costs and inflation.

Economics Team

FX: Many events on May 22 to keep DM currencies on the edge

GBP/USD faces resistance around 1.27-1.28 after its recovery from the year's low of 1.23 on April 22. **On May 22, profit-taking could set in on two significant events.** First, UK CPI inflation could decline near the 2% target in April from 3.2% YoY in March, which is in line with the Bank of England's expectation. Tomorrow, BOE Governor Andrew **Bailey will likely be confident about inflation moving in the right direction**, paving the way for a rate cut at the BOE meeting on June 20. At the last meeting on May 9, BOE Deputy Governor Dave Ramsden joined dovish member Swati Dhingra in voting to lower the bank rate by 25 bps to 5%. On May 23, BOE Chief Economist Huw **Pill may find enough confidence for a summer cut** before the US Federal Reserve despite caution over the tight labour market.

Second, the **FOMC minutes** for the May 1 meeting **will likely see the Fed refraining from a rate cut on June 12**. The USD Index (DXY) depreciated below 106 on May 1 after Fed Chair Jerome Powell reaffirmed that the next move would unlikely be a hike. DXY declined further below 105 on May 15 after US CPI inflation slowed to 0.3% MoM in April following three months of firm readings of 0.4%. However, **DXY quickly found support** a day later, **slightly above 104**, near April's low, its 100-day moving average, and the floor of a price channel. **The many Fed officials speaking this week should reinforce the narrative that US rates stay "high for longer"** to get inflation back to the 2% target. The New York Fed's Survey of Consumer Expectations reported that 1-year inflation expectations increased to 3.3% in April after holding at 3% for four months.

EUR/USD faces resistance after its month-long rally from 1.06 to 1.09. On May 22, **European Central Bank** President Christine Lagarde will likely reaffirm that the governing council **will not pre-commit to rate cuts beyond the one telegraphed for June 6**. According to its Spring forecasts last week, **the European Commission was modest in lowering its CPI inflation forecast** for the Euro Area to 2.5% from 2.4% previously for 2024 and to 2.1% from 2.2% for 2025. Although the EU economy exited its technical recession in 1Q24, the Commission kept the GDP growth forecast unchanged at 0.8% for 2024 and lowered 2025's projection to 1.4% from 1.5%.

NZD/USD, after a stellar 4.1% surge this month, has a hurdle around 0.6150-0.62. On May 22, we see the Reserve Bank of New Zealand keeping the official cash rate unchanged at 5.50%. Despite falling to 4% YoY in 1Q24 from 4.7% in the previous quarter, CPI inflation remained above the official 1-3% target. The **RBNZ's commitment to keep rates elevated for a sustained period may become more neutral and less hawkish**. A recent RBNZ business survey showed progress in lowering inflation expectations. One-year expectations fell to 2.73% in 1Q24 from 3.22% in the previous quarter, 2-year declined to 2.33% from 2.5%, and 5-year was unchanged at 2.25%.

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