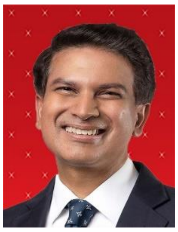
Macro Insights Weekly
End of inflation scare?

Group Research | September 23, 2024



Taimur Baig
Chief Economist
taimurbaig@dbs.com

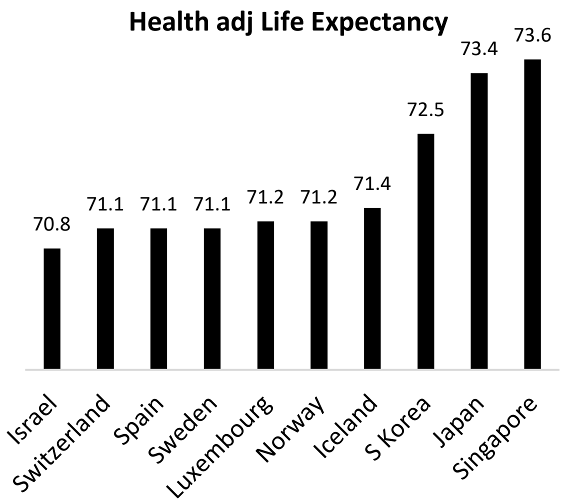
Radhika Rao
Senior Economist
radhikarao@dbs.com

For Alliance Bank clients, please direct your enquiries to
Malaysia Research +603 2604 3915 general@alliancedbs.com

- *Last week's 50bps rate cut by the US Federal Reserve marked the end of a concerted global effort to fight the post-pandemic inflation surge. Is inflation in the distant rearview mirror?*
- *Strikingly, bringing down the post-pandemic inflation surge did not entail a global recession.*
- *Nor was it necessary to have a crash in asset prices or a collapse in confidence.*
- *We see a key factor being the quick softening of commodity prices.*
- *Strong supply side response and China's weak demand drove this.*
- *We consider four key factors that bear watching in an otherwise benign price climate.*

Chart of the Week: HALE rankings

World Health Organisation publishes Health Adjusted Life Expectancy, which incorporates health status such as morbidity or disability into mortality statistics. This is to gauge not just quantity, but also quality of life. **Under this measure, Singapore ranks number 1 in the world**, followed by Japan and S Korea, leaving the rest of the pack behind substantially. Additional Asian entries in the top-50 are China, Brunei, Maldives, Sri Lanka, Thailand, and Vietnam. Strikingly, the US ranks 73.



Source: WHO, DBS. Indicator estimates lifespan minus years lost to chronic ailment and disability.

Commentary: End of inflation scare?

Last week's 50bps rate cut by the US Federal Reserve marked the end of a concerted global effort to fight the post-pandemic inflation surge. Inflation peaked in the summer of 2022, but it was followed by a prolonged period of anxiety with the respect to the outlook for prices. Some volatility in the data ensued, which appeared to threaten the path toward orderly disinflation. All that seems firmly behind now.

The welcome demise of inflation pressure did not entail a recession or a spike in unemployment, nor did it necessitate a crash in asset prices or a collapse in consumer confidence. The sharp rise in interest rates pursued by most major central banks in the world was absorbed remarkably well by the debtors at the household and corporate levels. Some distress was seen among several developing sovereign debtors, but that did not amount to manifestations of any kind of global systemic risk. Indeed, multilateral lending institutions engaged with the borrowers and lenders to manage the sporadic episodes of sovereign balance sheet stress. Some US regional banking faced difficulties in early 2023 owing to duration mismatch as rates soared, but that was dealt with swiftly by the Fed, with no global fallout.

How did the great escape happen? We think the answer lies in commodities. Just when supply chain disruption and other pandemic related distortions were beginning to ease in early-22, Russia's invasion of Ukraine caused a great deal of uncertainty about the price of food and oil/gas shipment worldwide. The following months were marked by peak inflation fear. Along with the cyclical issues were looming structural worries, from climate change to aging. The era of high inflation and rates seemed to have arrived.

But it has all turned out to be transitory. Global production and supply of food and energy have proven to be resilient, with soft demand from China also playing a moderating role. Against most expectations, commodity prices began to decline from 2H22 onward, and have remained soft through the past two years. Case in point is oil, which is presently trading nearly 40% lower (in real terms) than the peak of June 22. Compared to the all-time high (back in 2008), oil is down by 60%. This dynamic, to us, explains the journey of inflation and the global economies' ability to the absorb the 21/22 inflation shock better than any other.

Worries over global inflation have abated, although we will track four key factors ahead:

- First, global shipment costs, if they spike due to geopolitics, could be a spoiler.
- Second, US policy. If expansionary fiscal policy persists, it could weigh in on the dollar and a wide range of tradable goods. Tariff war is another element.
- Third, the direction of asset prices supported by lower rates and their spillover impact on consumer demand. This is the "melt-up" risk we have flagged previously.
- Fourth, China. Unlike the rest of the world, China has been grappling with weak demand and deflation risks. If and when ongoing efforts to revive the economy bear fruit, that could get the prices of metals/energy going again, which in turn could be consequential to global inflation.

Taimur Baig

FX: Fed cuts to lower the DXY below 100

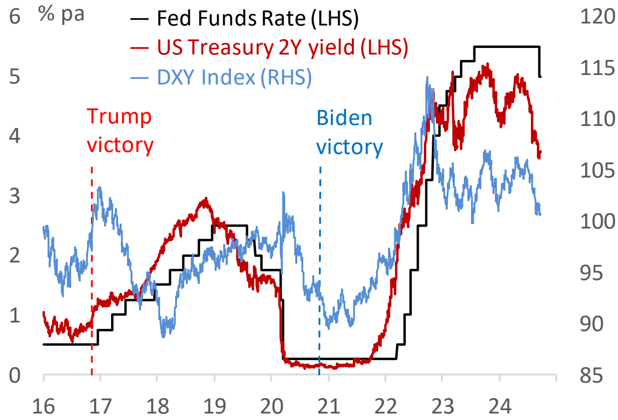
We have lowered our forecasts for the USD and US interest rates. Barring shocks to the global economy and financial markets, we see the DXY Index resuming its depreciation into a lower 95-100 range through 2025 on the Fed's rate-cutting cycle. This follows over 20 months of consolidation in a 100-107 range under the Fed's "high for longer" rates stance.

On September 18, the US Federal Reserve reduced the upper bound of the Fed Funds Rate (FFR) range with a significant 50 bps cut to 5%. **Based on our expectation for US GDP growth to become less exceptional at 1.7% in 2025 vs. 2.3% this year, we project a further cumulative 200 bps reduction in the FFR to 3% in 2025**, a notable revision from our previous projection of 4%. This Friday's US PCE deflators should validate Fed Governor Christopher Waller's concern about inflation running softer than anticipated. Fed officials speaking this week will reaffirm the commitment to avert a further cooling in the US economy and labour market. The return of a positive US Treasury yield curve (10Y vs. 2Y spread) should weigh on the greenback with its steepening bias.

Conversely, the **European Central Bank and the Bank of England did not lower their guard against inflation, showing little willingness to match the Fed's pace of rate cuts.** With their bond yield differentials leaning against the US, EUR/USD and GBP/USD have been supported above their psychological levels of 1.10 and 1.30, respectively, after mid-August. AUD/USD is also likely to hold above 0.68 on positive bond yield differentials, assuming the Reserve Bank of Australia defers rate cuts to 2025 at tomorrow's meeting.

On September 26, the Swiss National Bank should lower rates a third time by 25 bps to 1%. Last week, the Swiss State Secretariat (SECO) for Economic Affairs forecast CPI inflation decelerating to 0.7% in 2025 from 1.2% in 2024, aligning with the SNB's view that a strong CHF was curbing imported inflation and hurting Swiss exporters amid weak demand from Europe. However, USD/CHF may not break above its four-week range of 0.8400-0.8550. CFTC data suggested that its fall has been driven by an unwinding of short CHF positions, reflecting aggressive Fed cut expectations.

Next US presidential term will be about Fed cuts, not hikes



Sources: DBS Research, Bloomberg data

We do not expect the US Presidential elections on November 5 to support the greenback. Former President Trump's popularity has diminished, with Vice President Harris gaining favour after their presidential debate on September 10. Unlike 2017 and 2021, the next presidential term, beginning in 2025, will coincide with Fed cuts rather than rate hikes. Additionally, the ballooning US federal debt over the last two presidencies will constrain the incoming administration's economic policies.

Philip Wee

Group Research

Economics & Strategy

Taimur BAIG, Ph.D.
Chief Economist
Global
taimurbaig@dbs.com

Wei Liang CHANG
FX & Credit Strategist
Global
weiliangchang@dbs.com

Tracy Li Jun LIM
Credit Analyst
USD Credit
tracylimt@dbs.com

Amanda SEAH
Credit Analyst
SGD Credit
amandaseah@dbs.com

Nathan CHOW
Senior Economist
China/HK SAR
nathanchow@dbs.com

Eugene LEOW
Senior Rates Strategist
G3 & Asia
eugeneleow@dbs.com

Daisy SHARMA
Analyst
Data Analytics
daisy@dbs.com

Han Teng CHUA, CFA
Economist
Asean
hantengchua@dbs.com

Teng Chong LIM
Credit Analyst
SGD Credit
tengchonglim@dbs.com

Joel SIEW, CFA
Credit Analyst
SGD Credit
joelsiew@dbs.com

Mo JI, Ph.D.
Chief Economist
China/HK SAR
mojim@dbs.com

Tieying MA, CFA
Senior Economist
Japan, South Korea, Taiwan
matieying@dbs.com

Mervyn TEO
Credit Strategist
USD Credit
mervynteo@dbs.com

Byron LAM
Economist
China/HK SAR
byronlamfc@dbs.com

Radhika RAO
Senior Economist
Eurozone, India, Indonesia
radhikarao@dbs.com

Samuel TSE
Economist/Strategist
China/HK SAR
samueltse@dbs.com

Violet LEE
Associate
Publications
violetleeyh@dbs.com

Philip WEE
Senior FX Strategist
Global
philipwee@dbs.com

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