

Macro Insights Weekly

End of inflation scare?

Group Research

September 23, 2024



Taimur Baig

Chief Economist

taimurbaig@dbs.com



Radhika Rao

Senior Economist

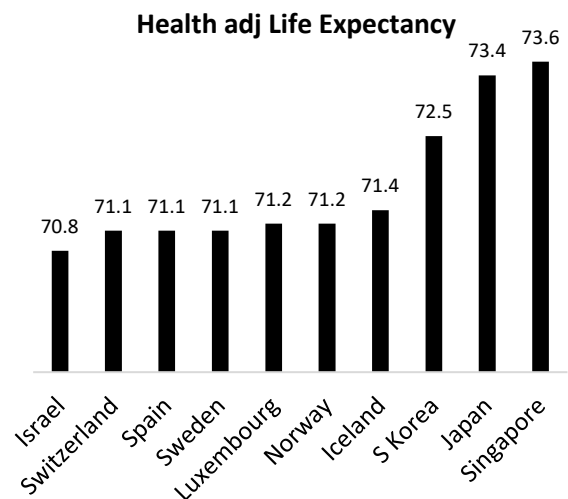
radhikarao@dbs.com

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 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

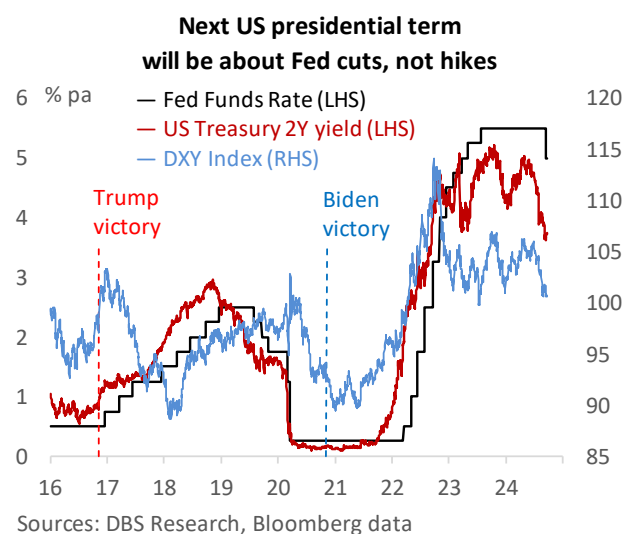
FX: Fed cuts to lower the DXY below 100

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.



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)

GENERAL DISCLOSURE/ DISCLAIMER (For Macroeconomics, Currencies, Interest Rates)

The information herein is published by DBS Bank Ltd and/or DBS Bank (Hong Kong) Limited and distributed by AllianceDBS Research Sdn Bhd (ADBS), a subsidiary of Alliance Bank Malaysia Berhad (ABMB) (each and/or collectively, the "Company"). It is based on information obtained from sources believed to be reliable, but the Company does not make any representation or warranty, express or implied, as to its accuracy, completeness, timeliness or correctness for any particular purpose. Opinions expressed are subject to change without notice. This research is prepared for general circulation. Any recommendation contained herein does not have regard to the specific investment objectives, financial situation and the particular needs of any specific addressee. The information herein is published for the information of addressees only and is not to be taken in substitution for the exercise of judgement by addressees, who should obtain separate legal or financial advice. The Company, or any of its related companies or any individuals connected with the group accepts no liability for any direct, special, indirect, consequential, incidental damages or any other loss or damages of any kind arising from any use of the information herein (including any error, omission or misstatement herein, negligent or otherwise) or further communication thereof, even if the Company or any other person has been advised of the possibility thereof. The information herein is not to be construed as an offer or a solicitation of an offer to buy or sell any securities, futures, options or other financial instruments or to provide any investment advice or services. The Company and its associates, their directors, officers and/or employees may have positions or other interests in, and may effect transactions in securities mentioned herein and may also perform or seek to perform broking, investment banking and other banking or financial services for these companies. The information herein is not directed to, or intended for distribution to or use by, any person or entity that is a citizen or resident of or located in any locality, state, country, or other jurisdiction (including but not limited to citizens or residents of the United States of America) where such distribution, publication, availability or use would be contrary to law or regulation. The information is not an offer to sell or the solicitation of an offer to buy any security in any jurisdiction (including but not limited to the United States of America) where such an offer or solicitation would be contrary to law or regulation.

This report is distributed in Singapore by DBS Bank Ltd (Company Regn. No. 196800306E) which is Exempt Financial Advisers as defined in the Financial Advisers Act and regulated by the Monetary Authority of Singapore. DBS Bank Ltd may distribute reports produced by its respective foreign entities, affiliates or other foreign research houses pursuant to an arrangement under Regulation 32C of the Financial Advisers Regulations. Singapore recipients should contact DBS Bank Ltd at 65-6878-8888 for matters arising from, or in connection with the report. This report is distributed in Malaysia by AllianceDBS Research Sdn Bhd.

DBS Bank Ltd., 12 Marina Boulevard, Marina Bay Financial Centre Tower 3, Singapore 018982. Tel: 65-6878-8888. Company Registration No. 196800306E.

DBS Bank Ltd., Hong Kong Branch, a company incorporated in Singapore with limited liability. 18th Floor, The Center, 99 Queen's Road Central, Central, Hong Kong SAR.

DBS Bank (Hong Kong) Limited, a company incorporated in Hong Kong with limited liability. 13th Floor One Island East, 18 Westlands Road, Quarry Bay, Hong Kong SAR

AllianceDBS Research Sdn Bhd (128540 U), 19th Floor, Menara Multi-Purpose, Capital Square, 8 Jalan Munshi Abdullah, 50100 Kuala Lumpur, Malaysia. Tel.: +603 2604 3915.

Virtual currencies are highly speculative digital "virtual commodities", and are not currencies. It is not a financial product approved by the Taiwan Financial Supervisory Commission, and the safeguards of the existing investor protection regime does not apply. The prices of virtual currencies may fluctuate greatly, and the investment risk is high. Before engaging in such transactions, the investor should carefully assess the risks, and seek its own independent advice.