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Macro Insights Weekly

Rising yields the last hurrah of this cycle

Group Research

October 9, 2023

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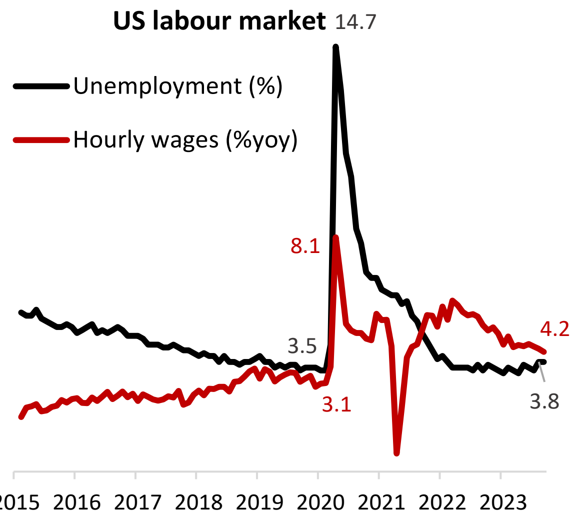
- *Markets' nerves are being tested by large supply of US bonds in the pipeline, chronic dysfunctionality at US Congress, and a further entrenchment of the Fed's "high for long" narrative.*
- *In the interim, data on wage growth and inflation have been moderating.*
- *But the rise in long-term yields marks a tightening of monetary conditions not seen since 2008.*
- *The saving grace is that tightening so far has not caused any financial stability concerns yet.*
- *2.5% real rate is not sustainable, in our view.*
- *A major asset market correction could be coming, or rebounding inflation will push down real rates.*

Key data release and events this week:

- *We expect the Monetary Authority of Singapore to keep all three SGD NEER policy parameters unchanged.*
- *China's export contraction is set to ease in Sep, alongside muted inflation.*
- *India's inflation to return to target in Sep.*

Chart of the Week: Jobs a plenty, yet soft wages

Friday's blockbuster jobs data (September payrolls were 336k, double of median expectations) underscore sustained strength in the US jobs market. But the development is juxtaposed with softening wage growth, which seems to be reacting more to falling inflation than the number of jobs available. Hourly wages were up 4.2% through September, a figure that would sooth Fed policymakers. This, and a rise in long-term interest rates ought to be enough for Fed policy to remain on pause.



Source: CEIC, DBS. Data through September 2023

Refer to important disclosures at the end of this report.

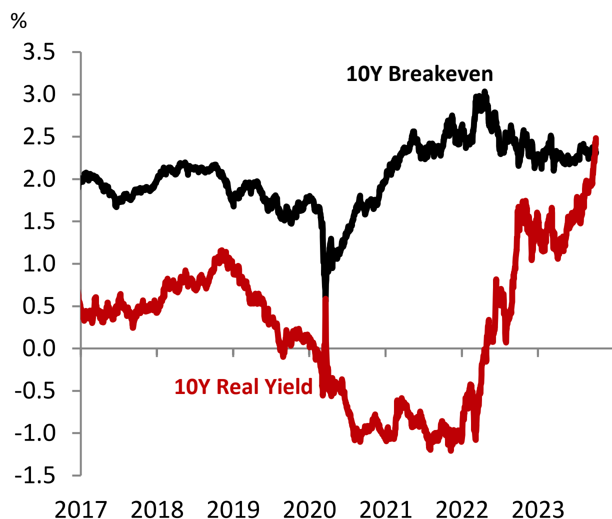
Commentary: Rising yields the last hurrah of this cycle

Closing at 4.8% at the end of last week, the US 10-year treasury yield has risen by 63bps since the beginning of September. This is a striking move, reflecting the market's growing nervousness about massive supply of US bonds in the pipeline, chronic dysfunctionality at US Congress (which makes much-needed fiscal consolidation a near-impossibility), and a further entrenchment of the Fed's "high for long" narrative.

This development is further striking for the fact that in the interim, data on wages and prices have been in line with a moderating trend through the course of this year. Both headline and core inflation rates have eased substantially year-to-date, and despite the labour market being tight, so has wage growth.

Nonetheless, the upward march of long-term yields marks a tightening of monetary conditions of a degree not seen since the 2008 global financial crisis. It is not just that real rates have marched toward 2.5%, but the pace with which this has transpired is unnerving.

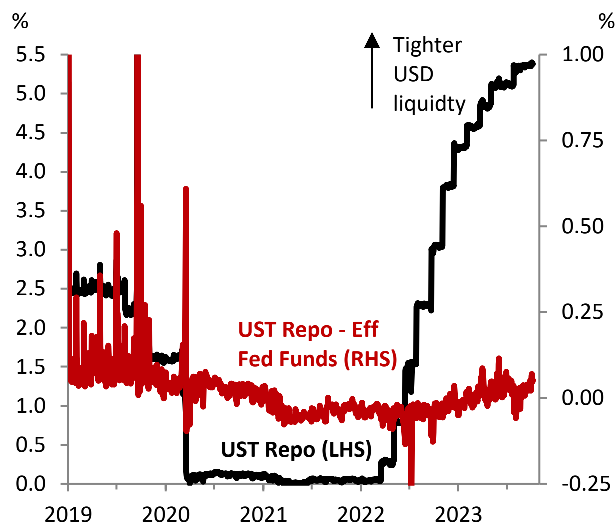
10Y US Real Yield vs Inflation Compensation



Source: Bloomberg, DBS

The saving grace is sustained hikes in interest rates, steady quantitative tightening, and recent rise in real interest rates have not caused any financial stability concerns yet. Government bond auctions, corporate refinancing, and money market operations are proceeding smoothly. The gap between treasury repo rates and effective Fed funds rate is hovering marginally above zero, an indicator we watch closely as a marker for tightness in USD funding.

Tightness of USD Funding - Repo



Source: Bloomberg, DBS

But how long can all this sustain? We don't believe that 2.5% long-term real rates are sustainable for the US economy. It will either lead to a major correction in asset markets, particularly equities and property, causing sharply negative wealth effect that will in turn lead to consumers curtailing consumption. Or another bout of inflation will push down real rates, but then add further upside to short-term rates and exacerbate duration risks. Either way, some pain on the economic growth front seems inevitable, in our view. Rising yield may well be the last hurrah of this cycle.

Taimur Baig

Key forecasts for the week

Event	DBS	Previous
Oct 9 (Mon)		
China: M2 (Sep)	10.6% y/y	10.6% y/y
Oct 10 (Tue)		
Philippines: exports (Aug)	-2% y/y	-1.2% y/y
- imports	-15.7% y/y	-15.3% y/y
- trade balance	-USD4.2bn	-USD4.2bn
Oct 11 (Wed)		
Taiwan: exports (Sep)	-3.0% y/y	-7.3% y/y
- imports	-13.8% y/y	-22.9% y/y
- trade balance	USD8.4bn	USD8.6bn
Oct 12 (Thu)		
US: CPI (Sep)	3.4% y/y	3.7% y/y
India: CPI (Sep)	5.3% y/y	6.8% y/y
India: industrial production (Aug)	9.0% y/y	5.7% y/y
Malaysia: industrial production (Aug)	-0.6% y/y	0.7% y/y
Oct 13 (Fri)		
China: CPI (Sep)	0.1% y/y	0.1% y/y
China: exports (Sep)	-7.5% y/y	-8.8% y/y
- imports	-6.0% y/y	-7.3% y/y
- trade balance	USD73.0bn	USD68.4bn
India: exports (Sep)	-3.1% y/y	-6.9% y/y
- imports	-8.5% y/y	-5.2% y/y
- trade balance	-USD23.7bn	-USD24.2bn
Singapore: GDP (3Q, A)	0.8% y/y	0.5% y/y
Singapore: MAS MPS	No change	No change

Central bank policy meetings

Monetary Authority of Singapore (MAS) policy review (Oct 13): We expect the MAS to keep the three parameters – mid-point, slope, and width – of **the SGD NEER policy band unchanged**. Please see FX section and Singapore chartbook: MAS to maintain status quo for more details.

3Q23 advance GDP estimates will also be released alongside the MAS's policy decision. We expect sequential growth to pick up to 1.0% QoQ sa, but translating to still soft expansion of 0.8% YoY. Overall services growth was supportive of the QoQ sa improvement. Accommodation and food & beverage services, as well as retail trade, likely outperformed, as they continue to be the key beneficiaries of the ongoing recovery in international tourism, and large-scale events. Trade-related services were likely resilient, as seen from the QoQ sa growth in re-exports and sea cargo handled. That said, finance was likely restrained by tight financial conditions. The manufacturing sector also remained the key drag to Singapore's economy, dampening overall growth, amid global external headwinds. However, manufacturing's sequential contraction probably narrowed further in 3Q23, as reflected in Jul/Aug industrial production data.

Forthcoming data releases

China: Contraction of exports is expected to ease from 8.8% YoY in Aug to 7.5% in Sep amid both low base comparison and moderating external headwinds. Leading indicator such as New Export Orders of Manufacturing PMI continued to improve. Despite elevated interest rates, the economic activities in DMs in particular the US remained resilient. IMF has also upward revised GDP forecasts for major advanced economies. Meanwhile, electronics downcycle appears to come to an end as reflected by the regional electronics exports. Likewise, imports are also showing relative improvement. In particular, commodity imports growth was apparent amid strong infrastructure investment demand.

On monetary front, M2 growth should have stayed at 10.6% YoY. Liquidity injection was largely neutral as the authorities are awaiting for the effect of previous stimulus to unveil. Coupled with the high base effect from food and energy price, CPI is expected to stay at 0.1% YoY.

Malaysia: Aug's industrial production (IP) was likely muted, dropping by 0.6% YoY. While IP bounced to 0.7% YoY expansion in Jul, this was due to mining and electricity outweighing manufacturing. Manufacturing likely stayed subdued, as Malaysian exporters still faced

global external headwinds, reflected in weak goods exports and manufacturing PMI numbers in Aug. However, base effects are likely to become more favourable over the coming months, while the electronics downturn would hopefully find a bottom.

India: September inflation is likely to provide a reprieve, with the headline at 5.3% YoY set to return to the target range after two consecutive months of elevated prints. Vegetable inflation decelerated in the month, whilst 'stickier' components like foodgrains, sugar etc continued to retain gains. Non-food trend should benefit from lower cooking gas prices whilst domestic subsidised retail fuel prices stayed shielded from high global crude oil levels. Notwithstanding a lower headline print, the RBI reiterated its preference to be cautious on inflation at last week's rate review. Industrial production is expected to jump on base effects and restocking ahead of base effects.

Taiwan: September trade data is set to be released this week. Exports are likely to exhibit a smaller decline of -3.0% YoY, compared to -7.3% in the previous month. This trend mirrors the positive developments in South Korea's September export figures, which showed a decrease of only -4.4% YoY. It appears that overseas demand for electronic components has stabilized, while demand for end-devices such as PCs and mobile phones is showing signs of recovery. This gradual and modest improvement in external trade conditions is expected to contribute to a U-shaped recovery in GDP growth starting from 4Q onward.

Economics Team

FX: DXY correction, Mideast fears, and MAS policy review

DXY reported its **first weekly loss** since mid-July. However, the DXY's 0.1% fall last week **was modest and considered a correction** to its support level of around 106. The greenback is backed by US exceptionalism against the weaker European currencies. Today, consensus expects the EU Sentix Investor Confidence index to decline to -24 in October, staying weak below -20 for a fourth month.

Fed Governor Michelle Bowman favours another hike and holding rates at a restrictive level for some time to return inflation to the 2% target in a timely way. **Many Fed officials speaking this week** may share her sentiment after the exceptional spike in US nonfarm payrolls to 336k in September. The US Bureau of Labor Statistics also revised August's NFP to 227k from 187k, leaving June as the only month with a reading below 200k. **Fed officials will watch this Thursday's CPI data, advanced US GDP on 26 October, and the PCE deflators on 27 October for its rate decision at the FOMC meeting on 1 November.** In line with the 2.3% MoM decline in WTI crude oil prices in September, consensus expects US CPI inflation to slow to 3.6% YoY (0.3% MoM) in September from 3.7% YoY (0.6% MoM) in August. The Atlanta Fed GDPNow model sees GDP growth jumping to 4.86% QoQ saar in 3Q23 after declining three quarters to 2.1% in Q23 from 2.7% in 3Q22.

The Middle East will matter this week. Israeli Prime Minister Benjamin Netanyahu warned of a "long and difficult war" after Hamas militants attacked Israel last Friday. Although the strike came on the 50th anniversary of the start of the Yom Kippur War, this was **not a repeat of the**

Arab-Israeli War that led to the 1973 oil crisis. Only a fortnight ago, Netanyahu told the United Nations General Assembly that Israel was on the cusp of a historic peace deal with Saudi Arabia brokered by the US. **Even so, markets fear that oil prices could rise on an escalating conflict broadening to Iran**, which Israel blamed for backing the Hamas attack. Iran said it was standing by the Palestinian fighters until the liberation of Palestine and Jerusalem. The US has vowed "rock solid" support for Israel and sent an aircraft carrier strike group to the eastern Mediterranean.

On 13 October, **we expect the Monetary Authority of Singapore to keep** the three parameters – mid-point, slope, and width – of **the SGD NEER policy band unchanged**. Located 1.5% above its mid-point, the NEER is consistent with the MAS's stance that it is not switching from "inflation-fighting mode" to "growth-supporting mode." In our view, keeping the band to an appreciating pace of 3% a year is equivalent to the global central banks' stance to keep rates "high for longer" and consistent with the MAS's projection for core inflation to fall to 2.5-3% by the end of 2023. Overall, USD/SGD is aligned with the USD's trend against the basket of currencies of Singapore's major trading partners. Since the DXY's rebound from its mid-July low, the lower half of our USD/SGD policy band has risen from 1.3140-1.3400 to 1.3620-1.3890 last week. We remain comfortable with our forecast for USD/SGD to end the year around 1.38.

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