Macro Insights Weekly
Support for US consumers

Group Research

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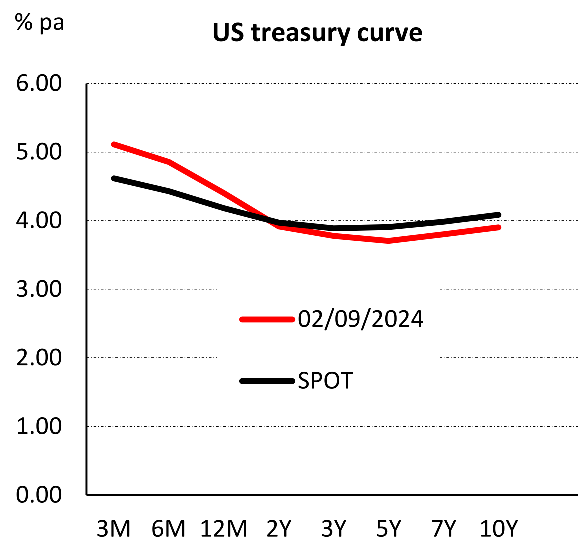
- *US consumption outlook is critical for Asia's exporters, as Americans account for 30% of global personal spending. Going into the final stretch of 2024, things look good.*
- *Consumer confidence is elevated, helped by moderating inflation and a strong labour market.*
- *Fiscal and monetary policy are both supportive of the cycle.*
- *Consumer debt is low, rates are coming down, and stock/property gains are substantial.*
- *Oil price spike could dent confidence, but overall commodity supply/demand picture is favourable.*
- *Key risk: "melt-up" of asset prices and spending, which could lead the Fed to scale back rate cuts.*

Chart of the Week: Confused US bond market

The near-and-medium term narrative around interest rates has become muddled. Strong views that the Fed would cut rates by 200+bps before mid-2025 have turned less assertive. Concerns about commodity prices around tensions in the Middle East, some signs of sticky inflation in the Sept US CPI print, and still-strong labour market data are raising questions about how far the Fed can go in the coming months. US yield curve, as a result, has nudged up beyond the 1-yr segment. A clear-cut rate cut cycle would require sustained disinflation and weak demand; may not happen.



Source: Bloomberg, DBS

Commentary: Support for US consumers

Accounting for 4% of the world's population, and yet around 30% of global spending, US consumers' outlook matters critically for producers and exporters. Going into the final stretch of 2024, they look in good shape, as per a number of indicators.

Let's begin with consumer confidence. University of Michigan's widely followed survey show confidence about 8% stronger than a year ago and 40% higher than the recent trough, in mid-2022. Inflation fears and jobs uncertainties have receded considerably over the last couple of years, although there may not be much room left for such data to improve.

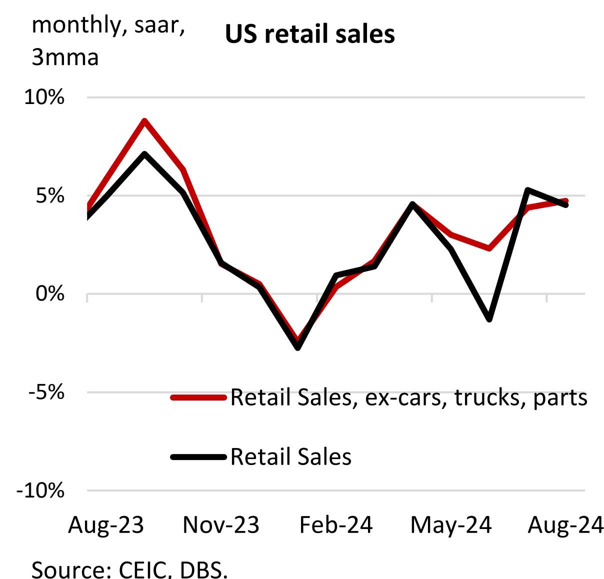
Nonetheless, there is ample tailwind for consumers. Capital gains from soaring equity and housing prices have been considerable in this cycle, mortgage rates have begun to decrease, household debt as a share of income is at a 22-year low, and real wage growth has picked up, making up from the 2021-22 inflation spike-driven erosion. With the unemployment rate at 4.1% and payrolls looking strong, there is every reason for US consumers to remain inclined to spend during the upcoming holiday season, in our view.

Additional support for consumers is in place. Fiscal policy remains supportive of the cycle, particularly from sustained increase in infrastructure spending. With the Fed beginning to cut interest rates, those in need of debt refinancing are about to get some relief.

All good stories come to an end, so how would this narrative of consumer strength get dented? The immediate risk is oil price, which is contingent on developments in the Middle East. A regional war could be damaging for global supply and push up pump prices, to which the US consumers are particularly sensitive. But oil prices, in real terms, are 60% below their all-time high, so consumers can readily absorb some upside. Besides, US oil production capacity is running at record high levels and global demand is muted. This may not be as big a spoiler as the media makes it out.

Instead, we think the risk is things get too hot, which can be thought of as a "melt-up" scenario. Helped by rate cuts, asset markets undergo a dizzying rally, consumers see that as a marker for the medium term, ending up over-extending themselves. That could inevitably lead to a sharp correction in the markets and associated collateral damage. But there are months and quarters to go before that risk becomes material.

The Fed will have to reckon with this risk soon, in our view, and may have to scale back markets' overwhelming expectations of a major rate cut cycle. That in turn could cause a bond market tantrum. US consumers may be feeling great, but policy makers' headaches remain.



Source: CEIC, DBS.

Taimur Baig

FX: Currencies pause as central banks fine-tune their monetary policy stances

This month's recovery in the DXY Index from 101.2 will likely be capped around 103.30. The futures market has trimmed its Fed cut bets, aligning with the Fed's projection for two 25 bps cuts in November and December. Fed officials have played down the higher-than-expected US nonfarm payrolls and CPI inflation readings. This week's Fed speakers should uphold the narrative that the US economy and labour market are back in better balance compared to two years ago, allowing inflation to return to the 2% target next year. The International Monetary Fund (IMF) will release the World Economic Outlook on October 16 and agree with the Fed regarding the scope for high interest rates to move from restrictive towards neutral levels.

We are cautious about the dovish bias for EUR/USD ahead of the 25 bps rate cut expected at the European Central Bank meeting on October 17. Although CPI inflation fell below the 2% target in September, the ECB is not prepared to declare victory on inflation because stubborn services inflation and a tight labour market have kept core inflation high at 2.7% YoY in September. On October 15, worries about the German economy could ease if the ZEW Sentiment Index rises for the first time in four months to 10 (consensus) in October from 3.6 in September., Germany's industrial production expanded 2.9% MoM in August; consensus had expected a milder recovery to 0.8% after the 2.9% contraction in July.

USD/JPY has a downside bias if it consolidates in a 145-150 range. Japan Prime Minister Shigeru Ishiba has affirmed the Bank of Japan's independence, looking to correct his earlier remark in early October about opposing future interest rate hikes. Heading into the snap election on October 27, the Ishiba government probably realized the critical role played by the BOJ's hikes in addressing the JPY's weakness, which is responsible for the higher cost of living besetting voters.

The next BOJ meeting is scheduled on October 31. During its next policy meeting on October 30-31, the BOJ should reaffirm its framework to hike rates and reduce JGB purchases if the economy performs according to its projections. On October 18, consensus sees National CPI inflation excluding fresh food falling to 2.3% YoY in September from 2.8% in August, below the BOJ's median forecast of 2.5% for Fiscal 2024 but above the 2.1% projection for Fiscal 2025. The 2Y and 10Y bond differentials between USTs and JGBs suggest that USD/JPY should be lower around 138-141.

Today, the Monetary Authority of Singapore's **decision to keep** all three parameters of the **SGD NEER policy band unchanged was largely expected.** The negative output gap is expected to close in 2H24 from this year's GDP growth coming around the upper end of the official 2-3% forecast range. Advance GDP growth expanded at a better-than-expected 4.1% YoY in 3Q24 vs. the consensus for a rise to 3.8% from 2.8% in 2Q24. The MAS forecasted core inflation to decline from 2.3% in July-August to 2% by the end of 2024 before entering a 1.5-2.5% range in 2025. USD/SGD should continue to take its cue from the currencies of its major trading partners. Our view remains that USD/SGD will trade lower in a 1.25-1.30 range on a lower DXY range of 95-100 driven by another 200 bps of Fed cuts to 3% from now to next year.

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