CIO Weekly

13 September 2022

Key Points

- **Equities:** Banks are direct beneficiaries of rate hikes; earnings momentum should quicken with rising rates as net interest margin continues to expand
- **FX:** DXY to stabilise after recent depreciation; EUR back inside its 0.99-1.01 range
- **Rates:** ECB finally gets serious about combating inflation; Interplay between ECB vs Fed policy will be key
- **Thematics:** Further regulatory easing for China's Internet sector in sight
- **The week ahead:** Keep a lookout for US Change in Initial Jobless Claims; Japan Industrial Production Numbers

GLOBAL CROSS ASSETS

Returns of cross assets around the world

Index	Close	Overnight	YTD
DJIA	32,381	0.7%	-10.9%
S&P 500	4,110	1.1%	-13.8%
NASDAQ	12,266	1.3%	-21.6%
Stoxx Europe 600	428	1.8%	-12.3%
DAX	13,402	2.4%	-15.6%
CAC 40	6,334	2.0%	-11.5%
FTSE 100	7,473	1.7%	1.2%
MSCI AxJ	626	0.6%	-20.6%
Nikkei 225	28,542	1.2%	-0.9%
SHCOMP	3,262	0.0%	-10.4%
Hang Seng	19,362	0.0%	-17.2%
MSCI EM	979	0.9%	-20.5%
UST10-yr yield*	3.36	4.8	184.8
JGB 10-yr yield*	0.24	-0.2	17.8
Bund 10-yr yield*	1.65	-4.4	183.2
US HY spread*	4.42	-7.0	159.0
EM spread*	403.55	-9.0	73.3
WTI (USD)	87.78	1.1%	16.7%
LMEX	3,763.40	1.7%	-16.4%
Gold (USD)	1,724.54	0.4%	-5.7%

Source: Bloomberg

* Changes in basis points

Equities: Rising rates drive profit outlook for ASEAN banks

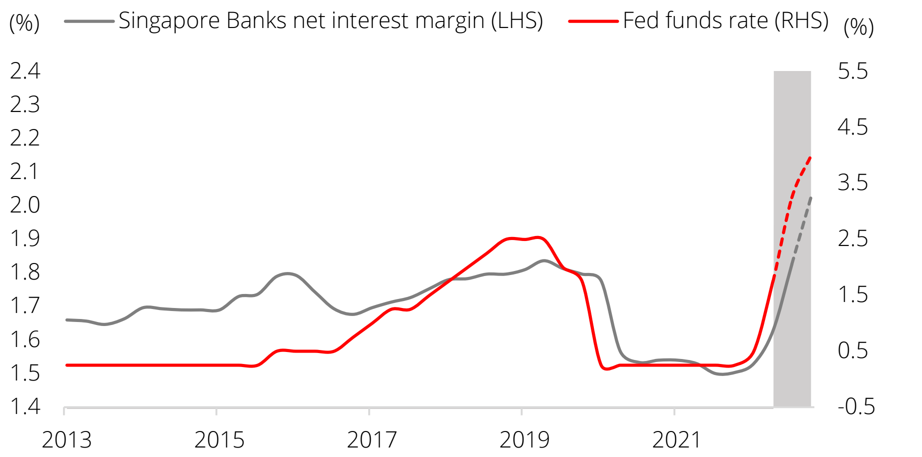
Interest rate hikes are increasing among ASEAN economies, catching up with the US Fed's hawkish stance. Indonesia and Thailand have delivered their first hikes since the pandemic, while the Philippines and Malaysia have hiked less than the Fed. We believe more tightening will be needed; improving policy differentials should help contain outflow risks and maintain financial stability since many regional central banks have already expended a fair amount of FX reserves in defending their currencies. Central banks would also be less behind-the-curve in tackling inflation as second round effects of inflation have started to kick in, amid a post-pandemic demand recovery in ASEAN economies.

ASEAN banks should benefit from interest rate hikes as net interest margin (NIM) looks to expand further. Banks with higher Current Account Savings Account (CASA) ratios should benefit the most. We believe valuation for ASEAN banks would be able to better ride through the negative feedback on equities in a rising interest rate environment. Earnings momentum should be positive against a backdrop of earnings downgrades in other industries due to global macro headwinds.

Interest rates in Singapore tend to follow US Fed rates closely. With our view that Fed rates will reach 4% by the end of this year, we expect Singapore Banks to benefit from higher interest rates and keep up their positive earnings momentum. We estimate that Singapore Banks will see c.3-8 bps increase in NIM for every 25 bps increase in rates, resulting in 3-6% earnings uplift. Economic reopening and higher inflation would continue to support nominal loan growth, especially mortgage loans. We note that despite macro uncertainties and the risk of rising interest rates, property buyers are back for projects with attractive attributes. This can be seen from the more than 10% rise in property prices in the core central region since two years ago and the robust sell-through rates of recent property project launches in Singapore.

Joanne Goh | Strategist

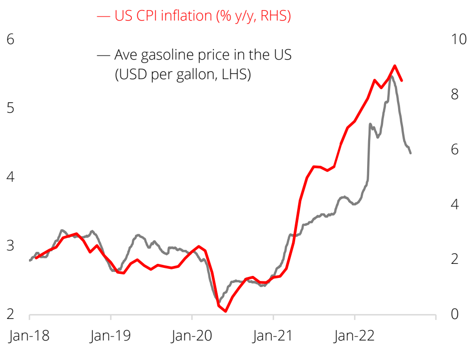
Figure 1: Singapore Banks' net interest income finally given a boost following a decade of near-zero interest rates



Note: Forecasts in shaded area

Source: Bloomberg, DBS

Figure 2: Fall in US CPI inflation slow vs gasoline prices



Source: Bloomberg, DBS

FX: US CPI this week, Fed hike next week

DXY to stabilise after depreciating for the first time in four weeks. The Fed is next in line, after the Bank of Canada and the European Central Bank (ECB), to deliver a jumbo 75 bps hike to 3.25% at the Federal Open Market Committee (FOMC) meeting on 21 September. The US Treasury 10Y yield firmed for the fifth week to 3.31%, while the 2Y yield rose to 3.56%. Our chief economist expects the Fed Funds Rate to peak at 4% in December through 2023.

Although Bloomberg consensus expects US Consumer Price Index (CPI) inflation to slow to 8% y/y in August from 8.5% in July, the Fed has already indicated that inflation would still be too high above its 2% target. Many Fed officials also cautioned against prematurely declaring victory over inflation. This morning (13 September), US Treasury Secretary Janet Yellen warned that gasoline prices might spike again this winter from the European Union's energy crisis. She also backed the Fed's stance to keep hiking to curb demand. After stripping out food and energy prices, core CPI inflation should rise to 6.1% (consensus) from 5.9%.

EUR is back inside its 0.99-1.01 range. At its governing council meeting last week (ending 9 September), the ECB acknowledged that the EUR's depreciation contributed to price pressures. After the Fed's Jackson Hole Forum, many major central banks were convinced by the Fed's resolve to control inflation with large hikes that would keep the USD strong. Hence, the ECB's jumbo hike of 75 bps last Thursday was probably aimed at supporting the EUR on an effective exchange rate basis rather than against the USD.

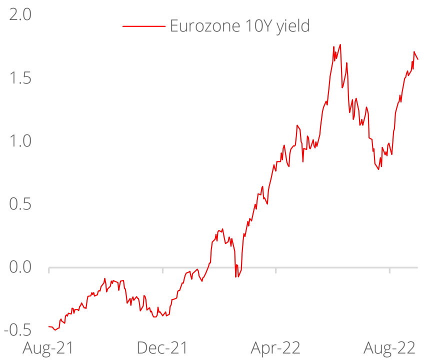
GBP is still trapped between 1.14 and 1.1650 in September despite its first appreciation in four weeks to 1.1590 last week. GBP bottomed earlier at 1.1406 last Wednesday on the passing of Queen Elizabeth II. Due to the national mourning of the monarch, the Bank of England (BOE) subsequently postponed the monetary policy committee meeting by a week to 22 September, resulting in some position adjustments in the markets.

On Wednesday, consensus expects UK CPI inflation to stay unchanged in August at 10.1% y/y and 0.6% m/m. After becoming the fourth prime minister since 2015 last week, Liz Truss vowed to push through her tax cut plans that many fear will add to inflation. Meanwhile, the consensus is for the UK economy to enter recession from 4Q22. Hence, the BOE hike next week is likely to be 50 bps to 2.25%, less than the Fed's expected 75 bps increase to 3.25%.

Philip Wee | FX Strategist

Rates: Aligning with higher for longer; improving growth/inflation mix

Figure 3: Heading higher



Source: Bloomberg, DBS

USD rates are quickly calibrating to our view that the Fed would be able frontload tightening even more. To recap, we now expect a terminal rate of 4% to be reached by the end of the year (75 bps, 50 bps, and 25 bps in the coming three meetings). The key reasons are that the US economy has proven to be remarkably resilient and financial conditions have eased, thanks to an asset market rally. This will provide confidence for further monetary tightening. With growth less of a concern, the priority returns to inflation.

A quick look at the high frequency indicators including NonFarm Payrolls and jobless claims suggest that there is continued labour market strength. Moreover, there are signs that the US may well exit the technical recession in 3Q. The NY Fed's Weekly Economic Index registered a decent bounce to 3.21% this week (ending 16 September), from 2.71% in the preceding week. In short, there are still no signs of a material slowdown that could derail further monetary tightening.

US Consumer Price Index (CPI) data (due 13 September) is arguably not as important for near-term Fed policy but could be very important for the market as a whole. It is widely expected that US CPI will fall further in August (consensus: -0.1% m/m, 8.0% y/y). However, two months of falling headline CPI, largely driven by falling food and energy prices, would probably not be sufficient for the Fed to declare victory. Instead, if CPI misses and there is a fall in USD rates, this should be paid into.

The mix of US economic strength and falling CPI is a more conducive mix for the market. To be sure, the Fed will still be a headwind. But with CPI falling, fear of runaway inflation should ease and allow the Fed to downshift later this year. This is line with our tweaked three peaks view where resilient US data keep the Fed hawkish for a while longer. We reiterate that peak inflation and peak inflation fears are already behind us. We would note that even as USD rates rose over the past two weeks, US equity markets performed relatively well. Aggressive short positioning and perhaps recognition that the US economy is heading into a more benign mix of resilient growth / slowing CPI probably contributed to this development. Put another way, the more benign market backdrop (easing financial conditions) might also mean that market participants are now more confident that the US economy will be able to withstand the rate hikes priced.

The European Central Bank (ECB) finally got serious about combating inflation, delivering 75 bps of hikes last week (ending 9 September), taking the Refi rate to 0.75%. Further hikes are in store as the ECB plays catch up to Consumer Price Index (CPI) and to the other Developed Market central banks. We have also adjusted our EUR rates forecasts a tad higher and see further flattening in the EUR rates / German Bund curve as likely, tracking the USD curve with a few months lag.

Eurozone (% pa)	2022F	2023F
3M EURIBOR	1.70	1.70
2Y	1.80	1.80
10Y	1.80	1.80
10Y-2Y	0	0

The interplay between ECB vs Fed policy is important. While the Fed has clearly been more aggressive than the ECB through the current cycle, the ECB is finally matching the Fed's pace. We also think that the Fed might well downshift (to 50 bps hikes) after September and this could well mean that the ECB, which arguably has a longer runway to hike given it started later, could play catch up. Interest rates differentials may no longer be as important a factor driving the two markets.

Falling European gas prices is the other critical factor. The surge in gas prices was one of the key differences between the US economy and why the Eurozone has symptoms that more closely approximate stagflation. With efforts being taken to cap prices and gas prices falling despite the indefinite closure of Nordstream 1, it could well be that another factor dampening EUR assets might well already have been fully priced and is in the process of reversing.

Similar to the US, while there are still challenges on the inflation front, it does look like peak inflation / inflation fears should already be upon / behind us.

Eugene Leow | Rates Strategist

Duncan Tan | Rates Strategist

Thematics: China Internet – Further regulatory easing in sight

- More concrete signs of regulatory easing since the beginning of the year
- Expect gradual growth recovery on improving profitability thanks to stricter cost control
- Sub-segment preference:

  Food delivery > e-commerce > online games

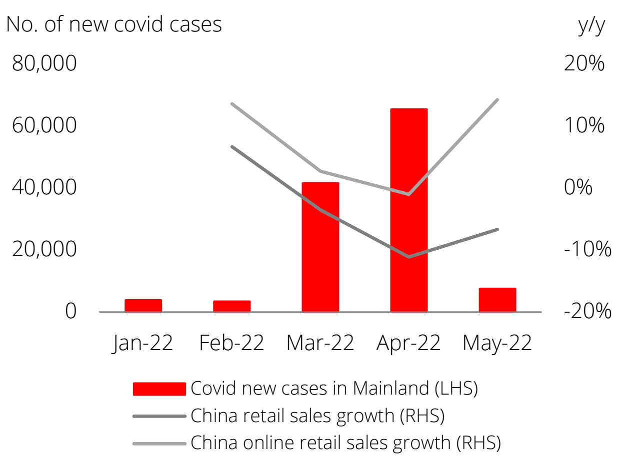
More concrete signs of regulatory easing. China's Internet sector witnessed positive regulatory developments in 1H22. This is consistent with DBS Group Research's analysis earlier this year that the government has switched its focus to stabilising economic growth in 2022. Currently, Internet players under our coverage are trading at undemanding valuation, around -0.5x to -1.5x SD below average. Looking into 2H22, we expect the sector to re-rate alongside the diminishing regulatory concerns and improvements in fundamentals.

Expect revenue growth to pick up. The weak performance in 2Q22 caused by Covid disruptions should have been well expected by the market. Yet, we saw economic activities and retail sales bounce back quickly after the easing of Covid measures in May. We expect growth to recover in 3Q22 along with the resumption of economic activities. Moreover, e-commerce players will become more rational on investment in new initiatives (e.g., community group buying) amid the challenging macro environment, which is positive to overall profitability.

Preference: Food delivery > e-commerce > online games. We are more confident on food delivery and e-commerce recovery in 2H22 as these two segments are immediate beneficiaries of economic recovery and stimulus policies. Besides, they are the first two segments that displayed the most significant rebound after the Covid reopening in 2020. Online game growth is set to rebound in 2H22. The regulatory overhang was removed after the resumption of game license approvals in April 2022. With the resumption of economic activities, we prefer stocks with robust growth and near-term catalysts.

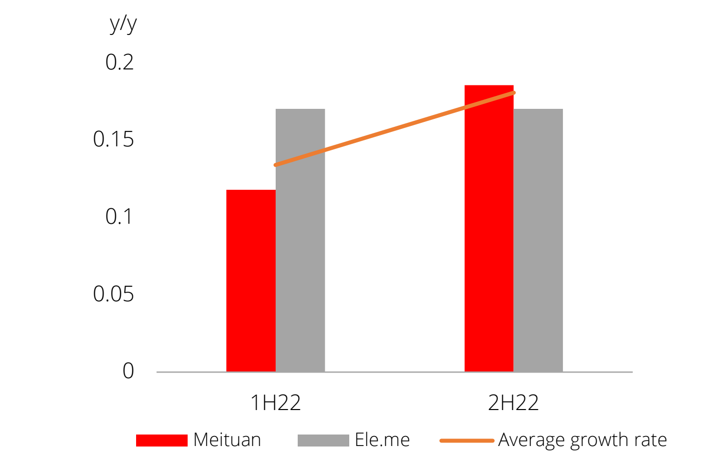
Tsz Wang Tam | Analyst
Lilian Lv | Analyst
Ryan Wang | Analyst

Figure 4: Retail sales rebounded after new Covid cases declined



Source: NBS, NHC.Gov, DBS

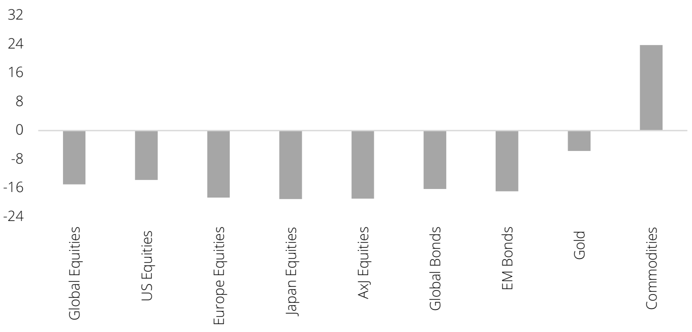
Figure 5: Food delivery gross transaction value growth (1H22 vs 2H22)



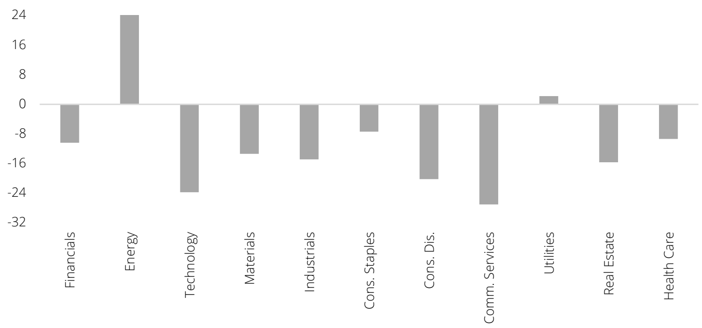
Source: Company, DBS

CIO Markets Watch

Global Cross Assets YTD Returns

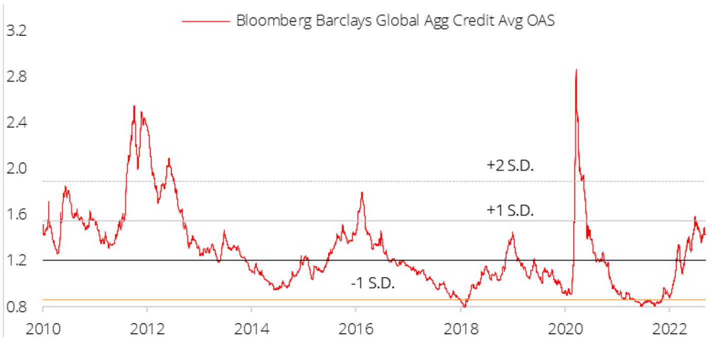


Global Sector YTD Returns



Global Equity Valuation

US Corporate Spreads



INDEX RETURNS

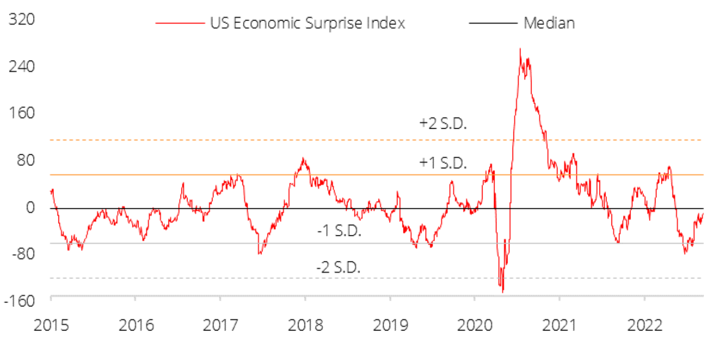
	1 week	MTD	QTD	YTD
Equities				
S&P 500	4.7%	3.9%	8.6%	-13.8%
NASDAQ	5.5%	3.8%	11.2%	-21.6%
Russell 2000	5.3%	3.4%	11.6%	-15.1%
Euro Stoxx 600	3.5%	3.0%	5.0%	-12.3%
Nikkei-225	3.3%	1.6%	8.1%	-0.9%
MSCI WORLD	4.7%	3.5%	6.8%	-15.9%
MSCI ACWI	4.3%	2.9%	5.7%	-16.4%
MSCI Asia ex-Japan	1.0%	-2.2%	-4.1%	-20.6%
MSCI EM	1.2%	-1.5%	-2.2%	-20.5%
HSCEI	0.8%	-3.5%	-13.5%	-19.5%
SHCOMP	1.9%	1.9%	-4.0%	-10.4%
Hang Seng	0.7%	-3.0%	-11.4%	-17.2%
STI Index	1.8%	1.6%	5.6%	4.8%
Fixed Income				
Barclays Global Aggregate	0.0%	-0.8%	-2.7%	-16.2%
Barclays US Aggregate	-0.8%	-1.0%	-1.5%	-11.7%
Barclays US High Yield	1.6%	1.4%	4.9%	-10.0%
Barclays Euro Aggregate	0.0%	-0.3%	-1.2%	-13.2%
Barclays Euro High Yield	1.2%	0.3%	3.9%	-11.0%
JPM EMBI Global	0.9%	0.4%	2.4%	-16.9%
JPM EMBI Global Diversified	0.7%	0.1%	1.9%	-19.6%

PRICES & SPREADS

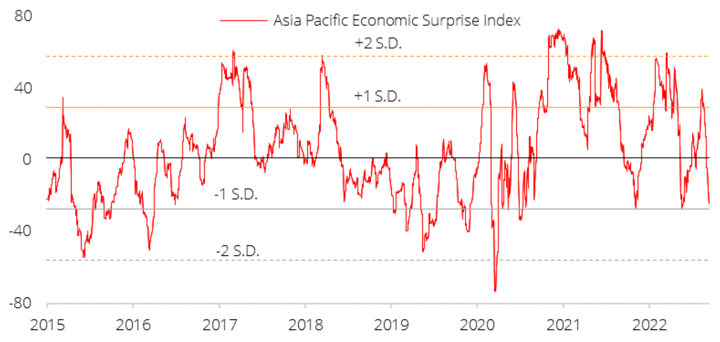
	Spot	2Q22	1Q22	4Q21
Rates				
Fed Funds Target	2.50	1.75	0.50	0.25
ECB Main Refinancing Rate	1.25	0.00	0.00	0.00
BOJ Policy Balance Rate	-0.10	-0.10	-0.10	-0.10
US Treasury 10-yr	3.36	3.02	2.34	1.51
Japanese Govt. Bond 10-yr	0.24	0.23	0.21	0.07
German Bunds 10-yr	1.65	1.33	0.55	-0.18
Spreads				
US Agg Corporate Spread	1.40	1.55	1.16	0.92
US Corporate HY Spread	4.42	5.69	3.25	2.83
Euro Agg Corporate Spread	1.96	2.15	1.31	0.97
EM USD Agg Spread	3.53	4.04	3.13	2.85
Currencies				
US Dollar Index (DXY)	108.3	104.7	98.3	95.7
EUR/USD	1.01	1.05	1.11	1.14
USD/JPY	142.8	135.7	121.7	115.1
USD/CNY	6.9	6.7	6.3	6.4
Commodities				
WTI Oil	88	106	100	75
London Metal Exchange (LMEX)	3763	3879	5174	4502
TR/CC CRB Commodity	288	291	295	232
Gold	1725	1807	1937	1829

CIO Economics Watch

US Economic Surprise Index



Asia Pacific Economic Surprise Index



MACRO CALENDAR

	Date	Period	Survey	Prior
United States & Eurozone				
Initial Jobless Claims (US)	15-Sep	10-Sep	227k	222k
CPI y/y (US)	13-Sep	Aug	8.10%	8.50%
CPI y/y (EU)	16-Sep	Aug	9.10%	9.10%
U. of Mich. Sentiment (US)	15-Sep	Sep	60	58.2
Retail Sales Advance m/m (US)	15-Sep	Aug	-0.10%	0.00%
Industrial Production m/m (US)	14-Sep	Aug	0.10%	0.60%
MBA Mortgage Applications (US)	14-Sep	09-Sep	--	-0.80%
PPI Final Demand m/m (US)	13-Sep	Aug	-0.10%	-0.50%

MACRO CALENDAR

	Date	Period	Survey	Prior
Asia				
Industrial Production m/m (JP)	14-Sep	Jul	--	1.00%
Core Machine Orders m/m (JP)	14-Sep	Jul	-0.60%	0.90%
Non-oil Domestic Exports y/y (SG)	16-Sep	Aug	8.40%	7.00%
PPI y/y (JP)	13-Sep	Aug	8.90%	8.60%
Tertiary Industry Index m/m (JP)	15-Sep	Jul	-0.10%	-0.20%
Industrial Production y/y (CN)	16-Sep	Aug	3.80%	3.80%
Retail Sales y/y (CN)	16-Sep	Aug	3.20%	2.70%
Capacity Utilization m/m (JP)	14-Sep	Jul	--	9.60%

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