CIO Weekly

GLOBAL ECONOMICS

24 March 2023

Key Points

- United States: Fed remains focused on fighting inflation, raising Fed Funds rate to 5%.
- China: Latest data reflects rapid normalisation of economy. PBOC's announcement of 0.25% cut to RRR to further boost economy.
- India: Above normal temperatures and uneven rainfalls could hit crop yields this year, impacting overall economy growth.
- Vietnam: State Bank of Vietnam announced rate cuts to support economy amid growth headwinds.

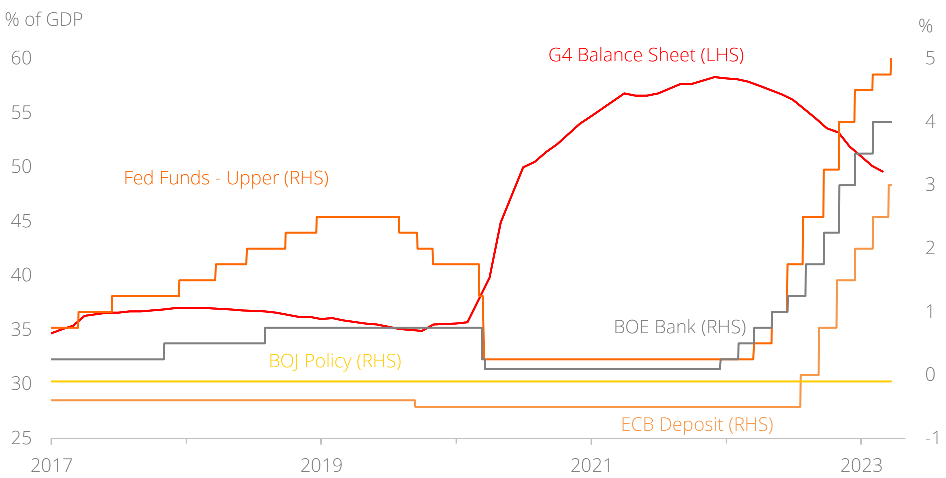
Focus of the Week

United States: FOMC - Fed maintains inflation focus. Stressing that labour market tightness persists while inflation remains elevated, the Federal Reserve's Open Market Committee (FOMC) continued with its path of policy rate hikes at the conclusion of its 21-22 March meeting, pushing up the Fed Funds rate to 5%. The recent collapse of several mid-sized banks was addressed early in the statement. While granting that these developments are likely to result in tighter credit conditions for households/businesses, and weigh on economic activity, hiring, and inflation, the FOMC reiterated its concurrent focus on inflation risks.

The FOMC is trying to thread the balance between varnishing its inflation-fighting credentials while acknowledging the impact of cumulative tightening in this cycle alongside the ongoing worsening of financial conditions due to the banking system crisis. Possible additional tightening was kept on the table (we believe one more 25 bps hike is left in this cycle, but the odds have weakened given recent developments) while the usual caveat about data dependency was underscored.

We have noted the market's deepening conviction that policy tightening is about to usher in so much softening of economic activity and inflation such that the Fed would be bound to cut rates several times before 2023 is over. We think this scenario is only possible if a major financial system setback ensues, in which banking system distress translates into an acute credit crunch. We also think that there is enough firepower in the hands of regulators and sufficient buffers at the household/corporate balance sheet level to prevent such a scenario from materialising. We maintain our forecast of around

Figure 1: G4 balance sheet vs policy rates



Source: Bloomberg, DBS

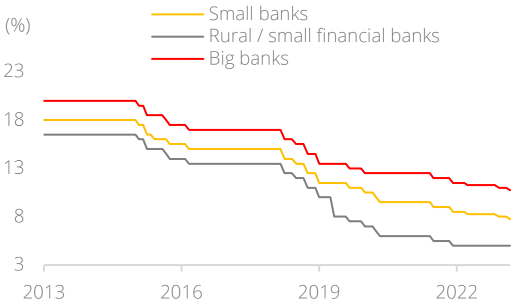
1% growth in 2023, as well as above-target inflation through the year.

MACRO CALENDAR

	Date	Period	Survey	Prior
US & Eurozone				
Initial Jobless Claims (US)	30-Mar	25-Mar	--	191k
GDP Annualised q/q (US)	30-Mar	4Q	2.70%	2.70%
U. of Mich. Sentiment (US)	31-Mar	Mar	63.4	63.4
Conf. Board Consumer Confidence (US)	28-Mar	Mar	101.5	102.9
MBA Mortgage Applications (US)	29-Mar	24-Mar	--	3.00%
Personal Income (US)	31-Mar	Feb	0.30%	0.60%
Personal Spending (US)	31-Mar	Feb	0.30%	1.80%
CPI m/m (EU)	31-Mar	Mar	--	0.80%
Asia				
Industrial Production m/m (JP)	30-Mar	Feb	2.70%	-5.30%
Jobless Rate (JP)	30-Mar	Feb	2.40%	2.40%
Manufacturing PMI (CN)	30-Mar	Mar	52	52.6
Tokyo CPI Ex-Fresh Food y/y (JP)	30-Mar	Mar	3.10%	3.30%
Job-To-Applicant Ratio (JP)	30-Mar	Feb	1.36	1.35
Non-manufacturing PMI (CN)	30-Mar	Mar	54.2	56.3
Retail Sales y/y (JP)	30-Mar	Feb	6.00%	6.30%
Tokyo CPI y/y (JP)	30-Mar	Mar	3.20%	3.40%

Source: Bloomberg, DBS

Figure 2: PBOC reserve requirement ratio



Source: Bloomberg, DBS

China: Normalisation on track. January-February 2023 data reflected the normalisation of the Chinese economies. Retail sales have improved, with a reversal from a contraction of 1.8% in December 2022 to an advancement of 3.5% in January-February 2023. Weekly automobile sales have returned to around 70% of pre-Covid levels, and traffic at major airports such as Guangzhou and Shenzhen has largely returned to pre-Covid levels. A declining unemployment rate is expected to continue supporting spending.

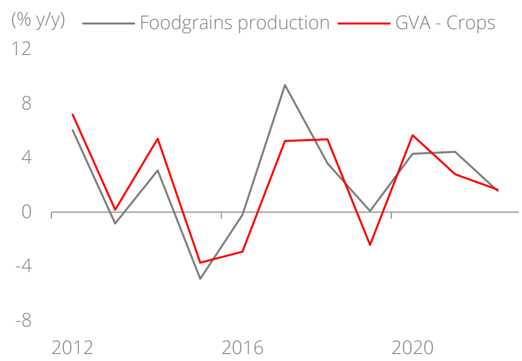
Export-led production has grown by 2.4% y/y in January-February 2023 (1.3% in December 2022), and capacity is catching up with demand, as reflected by soaring supply-side manufacturing PMIs. Improving high-frequency data, such as national railway freight traffic and the utilisation rate of power plants, points to strong, sustained normalisation. External demand has also surprised on the upside, with export volume growing by 10.2% y/y, alongside expanding PMIs of China's major trading partners.

State-led investment has also fueled upward pressure on credit growth, with fixed asset investment growing by 5.5% y/y YTD in January-February, up from 5.1% in December 2022. Investments in utilities and railways have soared by 25.4% and 17.8%, respectively. Thanks to Beijing's efforts in developing technological hardware and New Energy Vehicles (NEVs), investment in computer and communication, as well as automobiles, has leapfrogged by 17.3% and 23.8% respectively. In addition, the contraction in real estate investment has narrowed from 10% to 5.7%.

On the monetary front, the People's Bank of China (PBOC) announced a 0.25 percentage point reduction to the Reserve Requirement Ratio (RRR) last Friday, lowering the weighted average RRR to 7.6% for financial institutions. The cut benefits large and mid-sized banks, decreasing their RRR to 10.75% and 8.75% respectively. Smaller banks are unaffected given existing 5% RRR floors.

Further easing is expected and we believe the PBOC may trim the reserve ratio again in 2H as around RMB2.9t of medium-term lending facility funds mature. Replacing expiring MLF funds with broad-based RRR cuts could provide cheaper permanent funding to banks.

Figure 3: GVA crops & foodgrain output



Source: CEIC, DBS

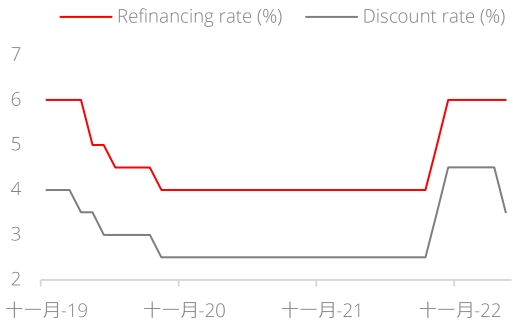
India: All eyes on impact of shifting weather conditions. In its recent update, the Indian Meteorological Department (IMD) forecasted 'above normal' temperatures from March to May 2023 in most states. A second consecutive year of heatwaves might be accompanied by an uneven bout of rainfall around mid 2023. February temperatures have already hit a record high, with unseasonal rains in the past week across various northern and western states reportedly affecting standing crops of wheat and selected vegetables in the north and north-west of the country.

Encouragingly, half of India's cropped area is irrigated, but the rest are vulnerable to evolving conditions. Current live water storage levels at the reservoir are higher than the 10Y average but with wide intra-state differences, which suggests timely rainfall will still be crucial to maintain such buffers. Delays in onset or belated withdrawal coupled with bouts of excessive rainfall are all risks for the final produce. Case in point: Last year's cycle witnessed above-normal southwest monsoon conditions on aggregate. Yet, the distribution of rain was uneven throughout different states (October 2022 rains were 47% higher than normal), thus affecting final crop outputs.

The government's second advance estimate for 2022-2023 farm production is upbeat, with total foodgrain output seen at a record high of 323m tonnes, of which the second largest grain sown, i.e., wheat is pegged at a record 112m tonnes, up 4% from the year before. Markets see a risk that the final output might be closer to 105-108m tonnes if harvests (planted in October-November and harvested in late 1Q) are impacted by unfavourable weather in a repeat of 2021-2022's events. Last year's below-forecast output had nudged officials to suspend wheat exports.

The agriculture sector is a crucial contributor to overall growth, accounting for 15% of GDP and c.45% of overall employment. Gross Value Added (GVA) crops, which make up half of the overall GVA agriculture forestry and fishing (AFF), and foodgrain output are highly correlated. A material shortfall in foodgrain output could hurt FY23 rabi crop output as well as FY24 kharif if weather conditions turn temperamental.

Figure 4: Key policy rates (%)



Source: Bloomberg, DBS

Vietnam: Dovish tilt amid growth headwinds. Vietnam became the first ASEAN central bank to pivot to the dovish side amid ongoing cyclical growth headwinds. The State Bank of Vietnam (SBV) unexpectedly cut several of its key interest rates, which took effect on 15 March. These included 100 bps reductions in the discount rate and interbank overnight lending rate, lowering them to 3.5% and 6.0% respectively, even though the refinancing rate was kept steady at 6%. The cap for dong loan rates for priority sectors was also lowered from 5.5% to 5.0%. These marked the first cuts since Oct 2020 during the pandemic. We reckon that it would only be a matter of time before the refinancing rate is also lowered, but such a move would be largely symbolic.

We think the decision to ease monetary conditions is a proactive move aimed at supporting the economy. The SBV has clearly shifted its focus towards growth, while inflation looks 'under control' and the currency is stable at present. We had flagged in early March that Vietnam was facing difficulties on both external and domestic fronts. The export-oriented industrial sector is under pressure, seen from the broad-based slump in the first two months of 2023. The bounce in Feb's manufacturing purchasing managers' index could signal some bottoming out in trade conditions, but the recovery would be gradual. Even if China's reopening is positive for the global outlook, advanced economies are still challenged by still-elevated inflation and tighter monetary conditions. Domestically, there have been pockets of liquidity crunch in the property sector. Easier monetary policy, coupled with updated regulations to alleviate the crunch in the corporate bond market – where property developers had tapped for short-term funding – could alleviate the liquidity situation.

Yet, policymakers still have plenty to juggle and be cautious on, which could deter an outright easing cycle as Vietnam is not yet fully out of the woods on inflation and downside FX risks. At 4.3% y/y, February's headline inflation is slightly below the SBV's 4.5% target, and core is still sticky at 5%. There is still uncertainty on the Fed's terminal rate amid sticky US inflation and could still spillover onto USD strength.

DBS Forecast

	GDP growth, % y/y				CPI inflation, % y/y, avg			
	2021	2022F	2023F	2024F	2021	2022F	2023F	2024F
China	8.1	3.0	5.5	5.0	0.9	2.2	2.5	2.2
Hong Kong SAR	6.3	-3.5	6.5	2.0	1.6	1.9	2.8	2.0
India	9.6	7.0	5.5	5.8	5.1	6.7	5.4	5.1
India (FY basis)*	9.1	7.0	5.8	6.0	5.5	6.8	5.2	5.0
Indonesia	3.7	5.3	5.0	5.0	1.6	4.2	3.7	3.2
Malaysia	3.1	8.7	4.0	4.8	2.5	3.4	3.0	2.5
Philippines	5.7	7.6	5.8	6.5	3.9	5.8	5.8	3.2
Singapore	7.6	3.6	2.2	2.8	2.3	6.1	5.8	4.3
South Korea	4.1	2.6	1.5	2.4	2.5	5.1	2.8	2.0
Taiwan	6.5	2.5	1.6	2.8	2.0	2.9	1.8	1.4
Thailand	1.5	2.6	3.4	3.8	1.2	6.1	2.5	2.0
Vietnam	2.6	8.0	6.0	6.5	1.8	3.2	3.8	3.5
Eurozone	5.3	3.3	0.9	1.5	2.6	8.4	5.6	2.5
Japan	2.1	1.0	1.2	1.0	-0.2	2.5	3.0	1.0
United States	5.9	2.1	1.2	1.2	4.7	8.0	3.9	3.0

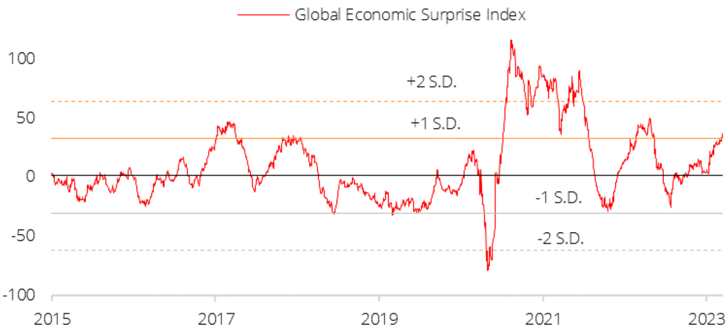
Source: CEIC, Bloomberg, DBS
*2020 represents Fiscal 21; ending 21 March

	Policy interest rates, eop							
	1Q23	2Q23	3Q23	4Q23	1Q24	2Q24	3Q24	4Q24
China*	3.65	3.55	3.45	3.45	3.45	3.45	3.55	3.65
India	6.50	6.75	6.75	6.75	6.25	6.25	6.00	6.00
Indonesia	5.75	5.75	5.75	5.75	5.50	5.25	5.00	5.00
Malaysia	2.75	2.75	2.75	2.75	2.75	2.75	2.75	2.75
Philippines	6.25	6.75	6.75	6.75	6.75	6.75	5.75	5.25
Singapore**	3.58	3.62	3.62	3.62	3.62	3.58	3.20	2.90
South Korea	3.50	3.75	3.75	3.75	3.25	2.75	2.50	2.50
Taiwan	1.88	1.88	1.88	1.88	1.88	1.88	1.88	1.88
Thailand	1.75	2.00	2.25	2.25	2.25	2.25	2.25	2.25
Vietnam***	6.00	5.50	5.50	5.50	5.50	5.50	5.25	5.25
Eurozone	3.50	3.75	3.75	3.75	3.75	3.75	3.50	3.00
Japan	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
United States	5.00	5.25	5.25	5.25	5.25	5.25	4.75	4.25

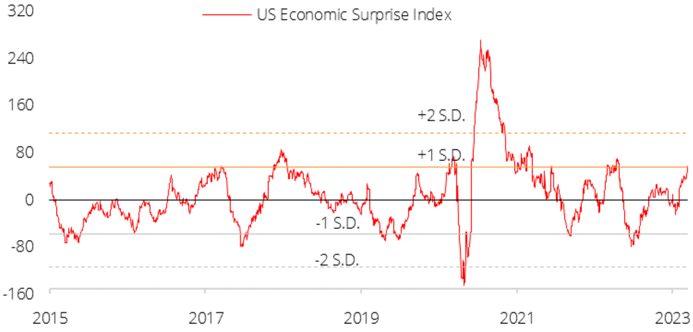
Source: CEIC ,Bloomberg, DBS
* 1-yr Loan Prime Rate; ** 3M SORA OIS ; *** refinancing rate

CIO Economics Watch

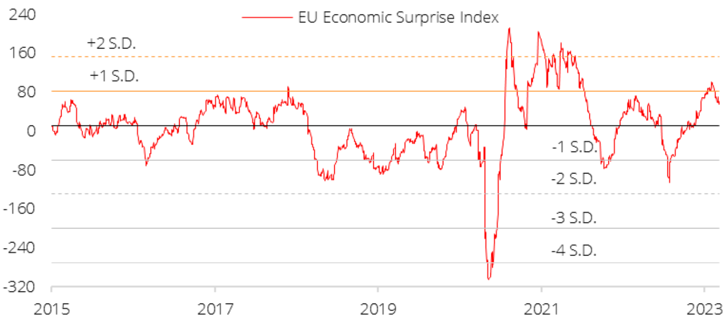
Global Economic Surprise



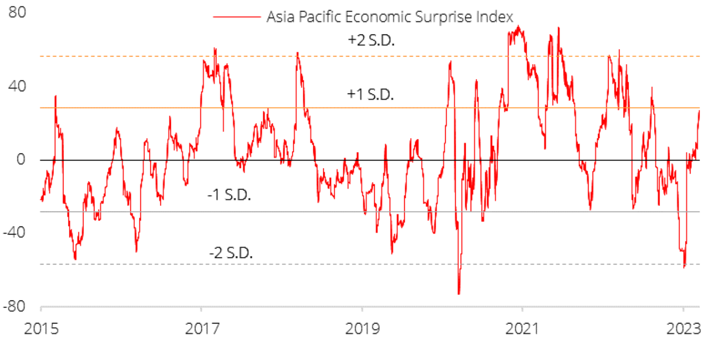
US Economic Surprise



Europe Economic Surprise

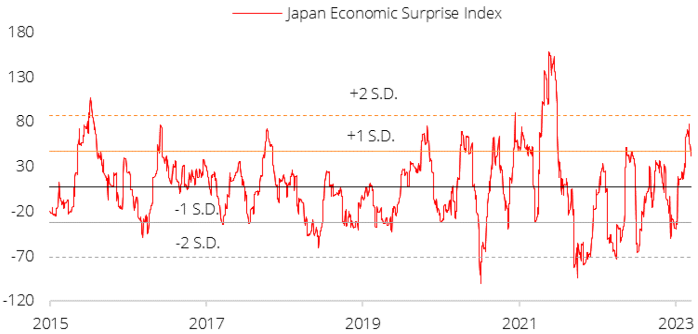


APAC Economic Surprise



China Economic Surprise

Japan Economic Surprise



Source: Bloomberg, DBS

US MACRO INDICATORS

	Mar-22	Apr-22	May-22	Jun-22	Jul-22	Aug-22	Sep-22	Oct-22	Nov-22	Dec-22	Jan-23	Feb-23
CORE CPI (%)	6.5	6.2	6.0	5.9	5.9	6.3	6.6	6.3	6.0	5.7	5.6	5.5
Headline CPI (%)	8.5	8.3	8.6	9.1	8.5	8.3	8.2	7.7	7.1	6.5	6.4	6.0
ISM Manufacturing PMI	57.0	55.9	56.1	53.1	52.7	52.9	51.0	50.0	49.0	48.4	47.4	47.7
ISM Service PMI	58.4	57.5	56.4	56.0	56.4	56.1	55.9	54.5	55.5	49.2	55.2	55.1
Initial Jobless Claims	3.6	3.6	3.6	3.6	3.5	3.7	3.5	3.7	3.6	3.5	3.4	3.6
Michigan Consumer Sentiment Index	59.4	65.2	58.4	50.0	51.5	58.2	58.6	59.9	56.8	59.7	64.9	67.0

Source: Bloomberg, DBS

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