CUIRS
INVESTMENT RESEARCH

13 November 2023

Global Market Wrap-up

Weakness everywhere

Multi-assets

Global

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- Oil price retreated to around $80/bbl amid weak global demand and intact supply.
- As the war appears to be contained that eases energy inflation concerns, investors' focus is back to economic momentum.
- DM central banks re-hawked, while EM Asia becomes more cautious for growth.

CUIRS Insight

Weak 30Y auction and Powell's hawkishness led to rebound in long-term treasury yield. While investors celebrated the last hike has passed after November FOMC, sticky inflation and fiscal concerns remain sustained headwinds for broader risky assets. The market now needs to weigh the effects of higher-for-longer against deterioration in US labor market.

China deflation is back. Headline CPI down 0.2% YoY in October. Though largely driven by pork prices, domestic demand has yet seen signs of recovery to support a reflation. The deflation print, after lower-than-expected PMI and exports, call for both fiscal and monetary stimulus at a larger scale after the RMB1tn CGB issuance.

Europe could enter recession as early as year end. Both BoE's Hailey and ECB's Lagarde pushed back rate cut speculations, but weakness is already everywhere. UK 3Q GDP was 0% QoQ with the help of exports and inventories that masks weak consumption. German housekeeping contracted with higher raw material prices and borrowing costs.

RBA hiked 25 bps after four pauses. Q3 CPI inflation surprised to the upside and labor market remains tight. RBA also revised inflation forecast upward and unemployment forecast downward, but we do not expect additional hikes going forward. We are slightly bearish on AUD primarily due to spillover from China weakness.

JGB yields could continue to rise with loose fiscal stance and BoJ normalization. While domestic pension funds and trust accounts are big buyers, higher fiscal premium, removal of 1% hard ceiling and increasing inflation expectation altogether push JGB yields. We expect 10y/30y to flatten given 10y policy sensitivity vs life insurers' demand on 30y.

In Asia, BoK started to tilt towards growth risks as oil price stabilized, expected to pivot in 2024 Q2 at the earliest. Taiwan saw sluggish non-tech exports and flat core inflation. We expect CBC to hold rates and prefer a gradually depreciating TWD. Indonesia grew at sub-5% for the first time, with broad-based weakness across consumption, export and investment. As IDR stabilized, we expect BI to refrain from another hike.

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US: Bear-steepened…again

Yields mildly rebounded after weak labor data in early November. US10Y rose from the lowest of below 4.5% back to 4.644% close. Dollar index retraced 0.69% this week (vs -1.40% the week before).

- **Weak 30Y auction**: The $24 billion 30Y UST auction on Thursday stopped out at 4.769% with a 5.3 bps tail (difference between the highest yield during auction and the expected high yield when auction starts), indicating weak demand. The tail was the largest since 2011, with bid-to-cover ratio falling to 2.24x (average of the past four auctions: 2.38x).

- **Powell speech**: Unlike the balanced November FOMC statement, Powell's opening remarks at an IMF event had a hawkish tilt. Powell mentioned the Fed will not hesitate to further hike rates if needed contain inflation, and he is "not confident" that the target of returning inflation to 2% has been achieved. While supply-side improvements have helped disinflation throughout the year, Powell considered further disinflation progress should come from demand-side slowdown with continued tightening. Overall, Powell is trying to dampen investors' enthusiasm about the end of rate hike cycle and still tilts towards inflation over growth in his dual mandate.

- **Higher inflation expectation**: Michigan 1-year/5-year inflation expectations rose to 4.4%/3.2% (vs 4.0%/3.0% expected, **Fig. 2**). The 5-year data is also the highest since the 3.3% in 2022 June (when CPI inflation was at its peak). While the Fed has reiterated its commitment to anchoring inflation expectation at 2%, these data releases trigger concerns about inflation stickiness. Still, weaker consumer sentiment index (60.4 vs 63.7 expected) and consumer expectations (56.9 vs 59.5 expected) counterbalanced some bear-steepening impact.

- **Moody's outlook downgrade**: Moody's announced a downgrade of outlook on US sovereign credit from Stable to Negative. Similar to Fitch, Moody's is concerned about elevated deficits and debt affordability in higher rates, without responsible fiscal practices that attempt to reverse the surging spendings or raise tax revenue. Polarized political dynamics could also lead to brinksmanship in resolving debt issues. These downside risks could no longer fully offset the advantages of US exceptionalism. Still, Moody's reaffirmed its Aaa rating on the US, different from S&P and Fitch.

Fig. 1: US yield curve bear steepened again

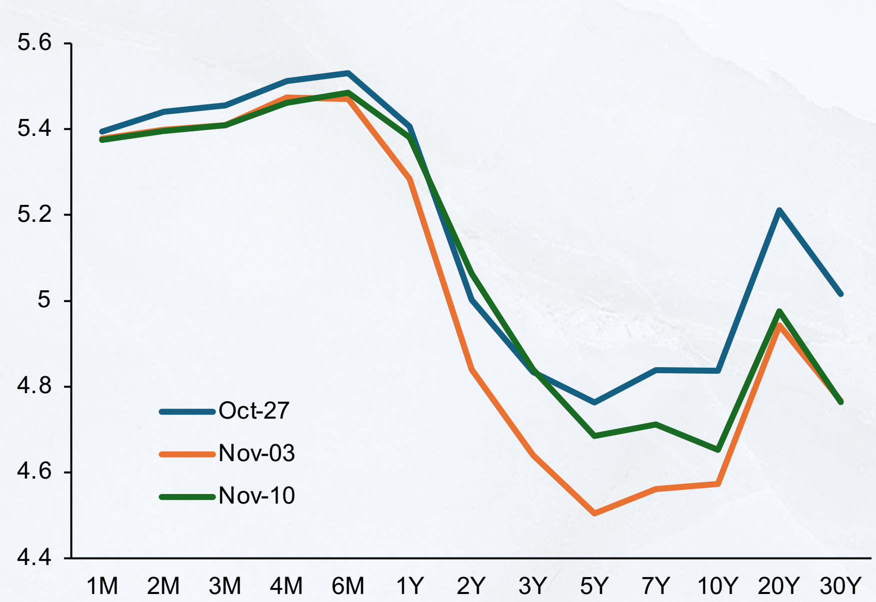
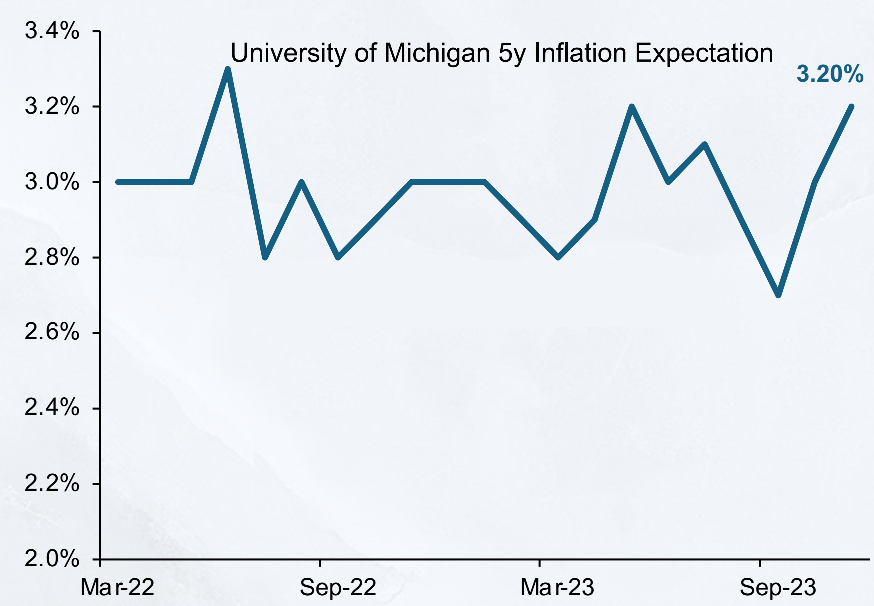


Fig. 2: Inflation expectation edged higher



China: Investors are still waiting for reflation

Deflation risk returns with the lower-than-expected October CPI falling 0.2% YoY (vs -0.1% expected, 0% September). Producer deflation continues as October PPI declines by 2.6% (vs -2.7% expected, -2.5% in September). While deflation prints could be viewed as one-off due to high base in pork prices, the underlying weakness in domestic demand remains worrying.

- **Sharp food deflation (Fig. 4)**: With heavy weighting of food inflation in China CPI, food price down 4% YoY and pork price down 30% YoY tipped China back into deflation. Pork price in China has long followed a boom-and-bust cycle, when now pig farmers have flooded domestic market with ample supply despite weak demand. NBS also highlighted abundance in agricultural product supply with better weather conditions and normalization of post-holiday consumption, with egg and vegetable prices down 5% and 3.8% YoY respectively.

- **Weaker service inflation**: Stripping food deflation, core CPI grew at 0.6% YoY, weakening due to lower travel activities, with travel inflation down 0.3% MoM. Service inflation grew at 1.2% YoY while consumption good prices was down 1.1% YoY, highlighting the persistent imbalance in recovery. Still, weakness in domestic demand is broad-based, with prices in housing, transportation, education and healthcare all being flat MoM.

- **Negative FDI for the first time**: Direct investment liabilities in China's BoP was down $11.8 billion in Q3 (**Fig. 3**), turning negative for the first time as foreign companies continue diversifying their supply chains, or friendshoring. Widening interest rate differential, more stringent regulations and "promise fatigue" in Beijing's pledges without meaningful policy support are also reasons leading to FDI outflows. Companies are eyeing countries like Japan, India and Vietnam as alternatives.

- **Stronger policy support warranted**: Despite the new RMB1tn CGB issuance for infrastructure spendings (0.8% of GDP), the reflation trajectory still appears bumpy and stronger supportive measures are needed to offset the sustained headwinds from property sluggishness and LGFV deleveraging. The central government could consider an even wider deficit and higher infrastructure spending given the current saving propensity, after breaking the 3% cap in October. PBoC could also cut loan prime rate and RRR further. Policymakers have to fight deflation decisively to avoid the spiral of weaker consumption and higher real debt.

Fig. 3: FDI turned negative for the first time

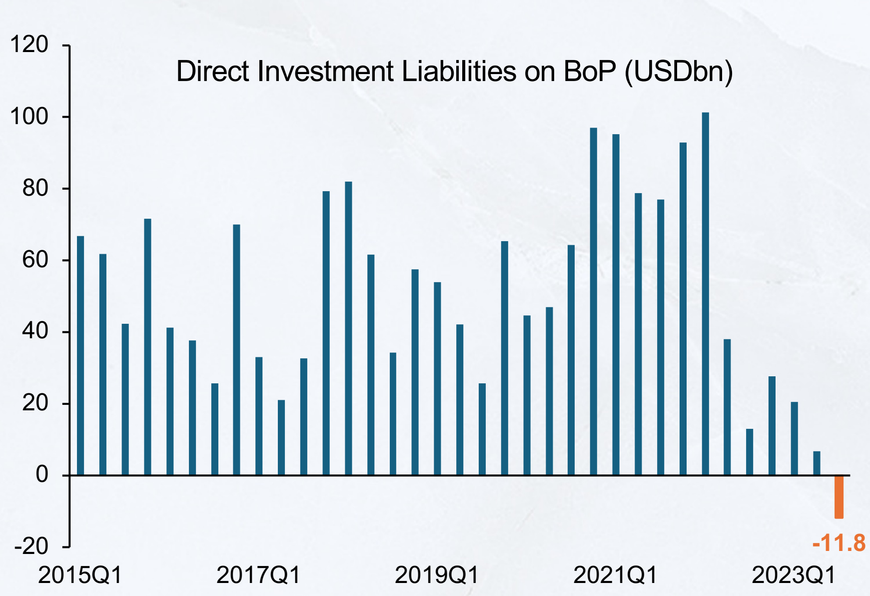
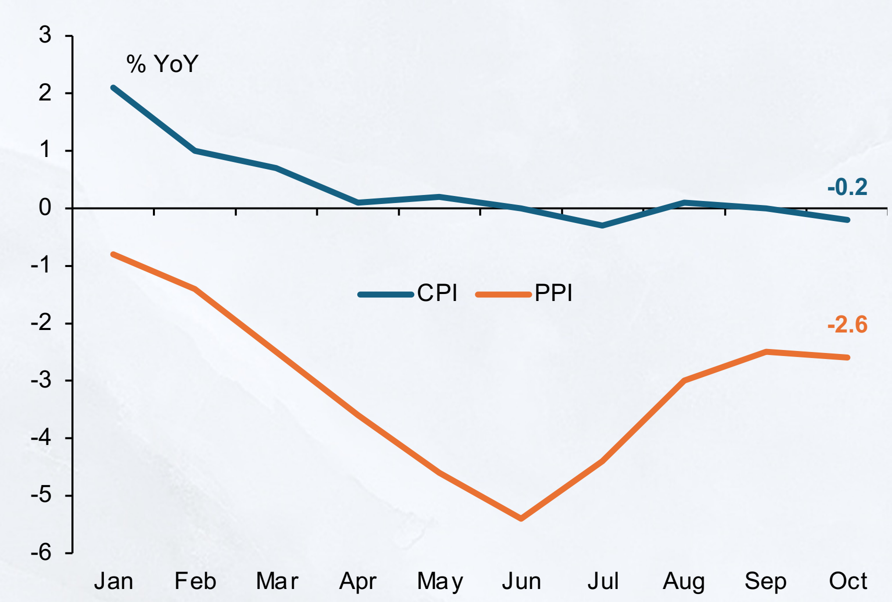


Fig. 4: China has stayed at the brink of deflation for half a year



UK: Better-than-feared GDP despite weak domestic demand

Major economic data was released on Friday. 10Y gilt was up 4 bps and GBPUSD was down 1.24% this week, primarily driven by US factors.

- **Better-than-feared growth data**: Q3 GDP is 0.0% QoQ (vs -0.1% expected), marginally avoiding a recession. However, the data composition still shows worrying signs of weak domestic demand. Real household expenditure/service output are down 0.4%/0.7% QoQ, while capital spending/business investment are down 2%/4.2% QoQ. The beat is primarily driven by exports and inventories, while the weak economic momentum remains intact.

- **Mixed signals between higher-for-longer and pivot:** Huw Pill, BoE's chief economist, commented market expectations for cuts from next summer as "not unreasonable". He also mentioned the BoE could consider or reassess its stance on rates in mid-2024. While the pivot tone has triggered a rally in gilt, Andrew Bailey, BoE's governor, tried to push back rate cut speculations and reiterated inflation risk, including Israel-Hamas conflict. Bailey stressed that monetary policy needed to remain restrictive "for an extended period", and he expected inflation to be back to target "in around a two-year horizon".

Euro Area: Verge of recession

Eurozone economic outlook remained gloomy, with 10Y Bund rebounding 7 bps to 2.717% close. Events in the week include:

- **Former ECB chief's pessimism**: Mario Draghi, former ECB president, expected a recession by the end of this year, a more pessimistic forecast compared to ECB and IMF, which expected a growth rebound in Q4 when Eurozone GDP was down 0.1% QoQ in Q3. Draghi warned the EU economy struggled to recover from consecutive crises due to fragile supply chains and global dependence (US for defence, China for trade and Russia for energy). He did not expect a destabilizing recession though, given the cushion of high employment.

- **Current ECB chief's hawkishness**: Lagarde mentioned ECB will not cut rates for "the next couple of quarters". While inflation could return to their 2% target with rates kept "long enough", Lagarde did not expect a change in the next couple of quarters. She pointed to a supply chock from energy sector as a upside risk to Eurozone inflation, which slowed from 4.4% to 2.9% in the latest reading. She stressed that the 2.9% rate should not be taken granted, and hinted a resurgence to higher numbers even if energy prices remain stable.

- **Weak construction and sales data**: HCOB Eurozone/Germany construction PMI was 42.7/38.3 in October. The German PMI was the lowest since the pandemic. German homebuilding was particularly weak with elevated raw materials prices (40% higher than pre-covid) and higher borrowing costs. House prices were down 10% YoY in Q2, while German building permits also fell more sharply than European average. On the other hand, September Eurozone retail sales was -0.3% MoM (-0.2% expected), the seventh month that is lower than forecasted. PPI was 0.5% MoM (0.5% expected), starting to reverse the disinflation trend this year.

Australia: Another 25bp hike with tightening bias retained

The RBA delivered a 25bp hike to 4.35% last week after four months of consecutive pauses, taking the sum of the hiking phase to 425bp. The case to hike was stronger than to pause at this meeting as “inflation is proving more persistent than expected a few months ago”.

The Bank now stays data dependent: “Whether further tightening of monetary policy is required to ensure that inflation returns to target in a reasonable time frame will depend upon the data and the evolving assessment of risks”. While the RBA keeps room for more rates hike, we see this hike as an insurance hike to reinforce the hawkish stance, and we don’t expect any further tightening, if no any external shock.

In our view, the proximate trigger for today’s hike was the upside surprise to the Q3 CPI inflation figures, but, as today’s statement suggests, the board had also received new information on activity and the labour market which allowed a revised set of forecasts. The statement noted that the ‘weight of this information suggests that the risk of inflation remaining higher for longer has increased’. The RBA noted that growth and underlying inflation had been stronger than expected and although the labour market had eased, it remained ‘tight’ and housing prices continued to rise.

Ahead of the Statement on Monetary Policy due on Friday, RBA’s inflation forecast was revised upwards to ‘around 3.5%’ by the end of 2024 (up from 3.3% previously). Inflation is still forecast to fall back to the top of the 2 to 3% target band by end 2025, in part because today’s rate rise will allow the board to be ‘more assured that inflation would return to target’ over this time frame.

Unemployment is expected to continue to increase through the forecast horizon, but at a softer pace than assumed earlier. The projections now show the unemployment rate peaking at 4.3% by end of 2025, compared with 4.5% earlier. This is because of both a better outlook for domestic activity and stronger growth in population. That said, while spending has picked up ahead of the Christmas period, the retail sector’s outlook for the next 12 months is pessimistic (NAB, **Fig. 5**).

From FX perspective, we are slightly bearish on AUD given the fragile growth momentum of Chinese economy and the uncertainty on trajectory of US economy deterioration. Although we claim that the USD had peaked, but market is still trading on several negative themes like US exceptionalism, risk aversion and weakness in China’s property sector, which move against the AUD. Hence the Aussie is likely to underperform most of its G10 peers (**Fig. 6**), as well as the Kiwi. In the near term, The material rebound on the currency require 1) a sustainable USD downturn trend; 2) Bazooka on China’s policy stimulus, both of which are unlikely to be seen. That said, long AUDNZD looks attractive as Australia holds relatively strong fundamentals (More excess saving, current account surplus, and status of energy exporter), while the RBNZ has started re-building its intervention capacity.

Fig. 5: Business Confidence remain fragile

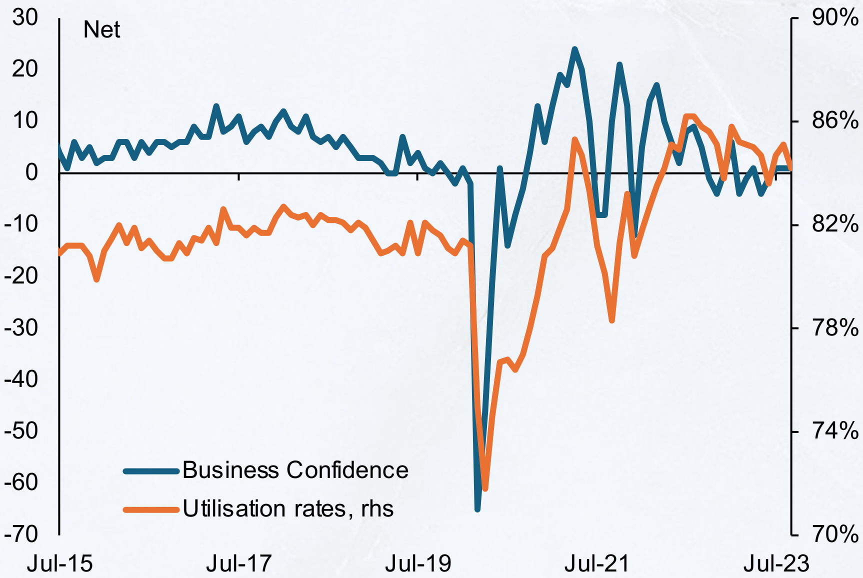
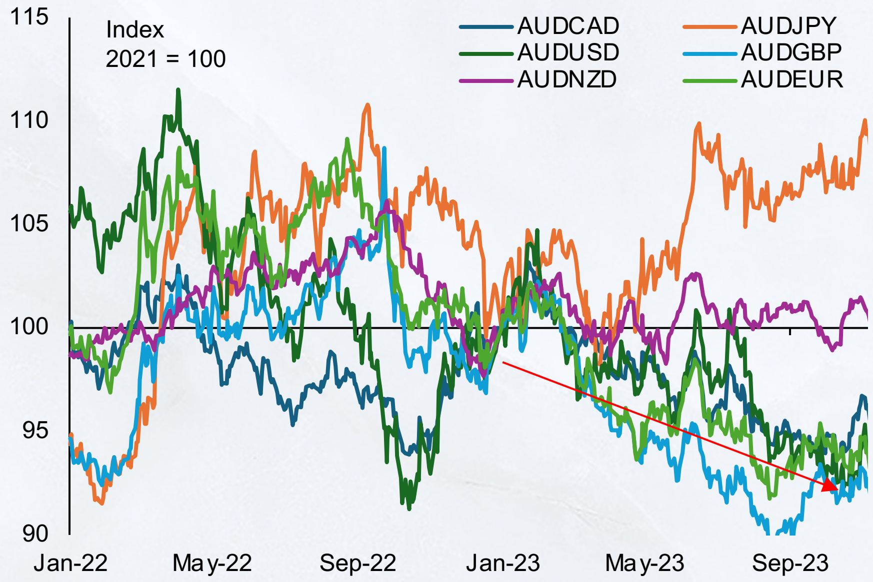


Fig. 6: AUD is likely to keep underperforming most of G10



Japan: Outflows continue amid ultra-weak JPY; fiscal stance raise concern

On Nov 9, Japan's MoF released Balance of Payment (BoP) data for Sep and a preliminary portfolio investment report for Oct. Japan 's basic BoP returned to deficit in 3Q23 (**Fig. 7**) as a rise in net outward FDI offset current account surplus. Japan's outward FDI appears to be insensitive to the FX rate as the primary driver appears to be demographics.

Japan's pension funds slightly reduced exposure to risk assets in October. We estimate that they are slightly overweight domestic bonds (25.8% vs 25% target) and underweight foreign bonds (24.4% vs 25% target) and Japanese equities (24.6% vs 25% target). Japanese trust accounts have been buying JGB since the beginning of this fiscal year, supporting JGB amid the BoJ's policy tweak. However, Investment trusts continue to buy foreign equities. Over the past decade, Japanese investment trusts have continually bought foreign equities, which we think reflects retail investors' declining domestic bias (**Fig. 8**). Outward investment by retail investors may accelerate in 2024 as expanded NISA (Nippon Individual Savings Account) begin.

However, We are concerned that the government's loose fiscal policy stance would raise fiscal premium and weaken the yen. Japan's internal imbalance stands out with its gross public debt to GDP ratio above 250%. The IMF expects Japan to keep running primary balance deficit above 2% of GDP for its forecast time horizon. Japan has relied on fiscal subsidies to ease the burden of import inflation on consumers and the government decided on cash handouts and income tax cuts to be included in the economic package. While additional JGB issuance may be avoided, the lack of a change in the government's loose fiscal policy stance could raise the fiscal risk, in turn trigger 5yr sovereign CDS spread to widen to 31bp from 16bp since July.

Following BoJ's movement, we also discuss more reasons why we expect JGB yields will continue to rise below.

- **Lack of policy intervention**: With the latest YCC tweak, YCC has lost the hard ceiling. The BoJ acknowledged the side effect of defending the 1% ceiling and clarified the side effect included FX volatility. Governor Ueda also said he didn't expect 10yr JGB yields to rise above 1% substantially but did not say the 10yr was unlikely to rise above 1% either. In our view, BoJ's policy intervention would be to slow the rise in the yield but not to cap the yield at a specific level.

- **BoJ policy still too easy**: The BoJ's policy is still too easy compared to major central banks, reflecting the BoJ's cautious stance in policy normalization. Ueda previously said he was more willing to tolerate the risk of being behind the curve than of being premature. Easy policy would continue to raise Japan's inflation expectations first, and eventually normalize the real yields toward flat as the BoJ proceed with further policy normalization.

But since 10yr would be more sensitive to the BoJ's policy change while the superlong sector would be supported by life insurers' demand especially in the final quarter of fiscal year, 10yr-30yr may have a flattening bias.

Fig. 7: Basic BoP turn deficit again in Q3

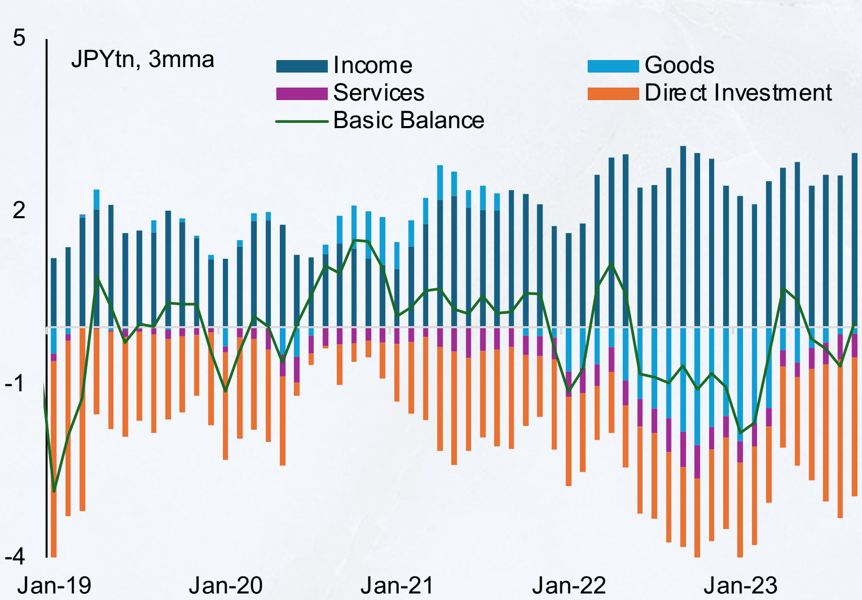
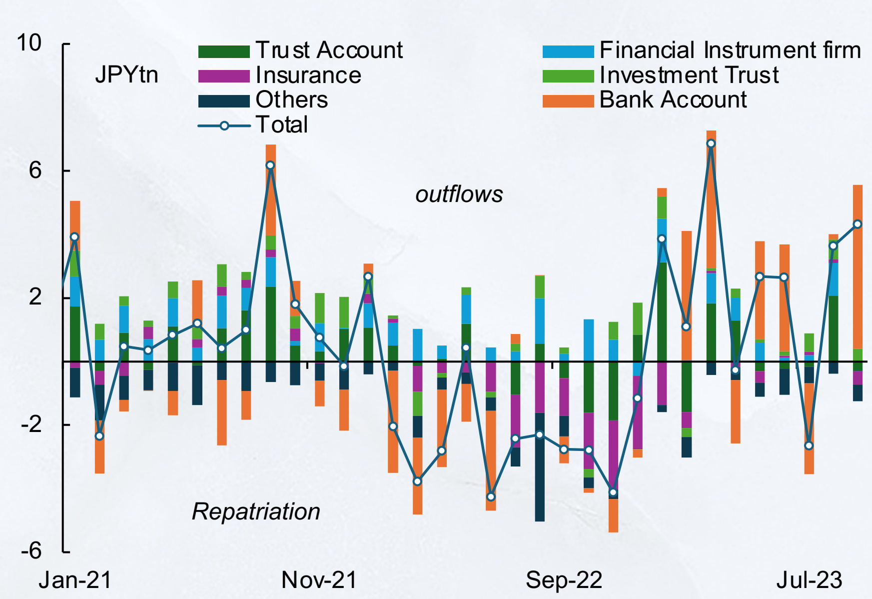


Fig. 8: Japanese portfolio investment outflows continue in Oct



South Korea: Prolonged hawkish while slightly shift focus to growth

The October MPC minutes released underscore BoK's concern about upside risks to inflation from oil prices and FX risk if the Israel Hamas conflict escalates further. However, Since the October MPC meeting, crude oil prices have stabilised, likely mitigating the upside risks that the MPC members broadly discussed. The BoK also turned more cautious on growth and less concerned about financial stability risks.

We believe one reason the BoK stuck a more hawkish rhetoric in the October meeting was shown in the MPC's discussions around monetary policy. A few members stressed the importance of a communication strategy to adjust expectations for premature easing and of closely reviewing the market expectation for the policy direction of major central banks "higher-for-longer" regime.

Such higher-for-longer rhetoric could pressure on financial conditions and FX, especially against the unfavorable backdrop of a China slowdown and financial imbalances in Korea. Against this backdrop, the BoK has revealed its playbook to secure policy capacity through a consistent response to inflation and financial imbalances, while devising an adequate market stabilization method against possible economic shocks or financial instability.

The minutes show members getting more concerned about the growth outlook. Even the most hawkish member, who suggested considering a hike at the upcoming meeting, noted slower consumption growth. With most members seeing some uncertainties to the trade growth outlook into 2024, we believe the skew in monetary policy is tilted towards downside risks and concern over a below-trend consumption recovery.

There're also some nuances around financial stability mandates in the minutes. The BoK expects household loan growth to slow as transaction volumes are decreasing. Similarly, bank lending officers have tightened lending attitudes against mortgage loans, likely suggesting tighter credit control from the banks and more surprisingly, loan demand for mortgages is falling. As such, we also expect household loan growth to slow.

BoK's overall stance in October was to wait and see how the Israel-Hamas conflict turns out and its spillovers to the oil prices. Against the backdrop of still-high price pressures with accumulated cost pressures for businesses not yet fully transferred to consumers, increased oil prices and a subsequent pick-up in inflation expectations could keep price pressures elevated for some time, in our view. Meanwhile, muted consumption demand (partially triggered by almost-zero real wage growth (**Fig. 9**) would call for some easing in real rates (**Fig. 10**).

We maintain our view that the BoK's policy pivot could happen as early as 2024 Q2 with a 25bp cut. From a very conservative stance, we see fiscal policy turning slightly more supportive of growth. In addition, recent short-sale ban in KOSPI and the new special loans for family who have newborn babies suggest that the government is skewed to some pro-demand policy.

Fig. 9: Real wage growth slow notably

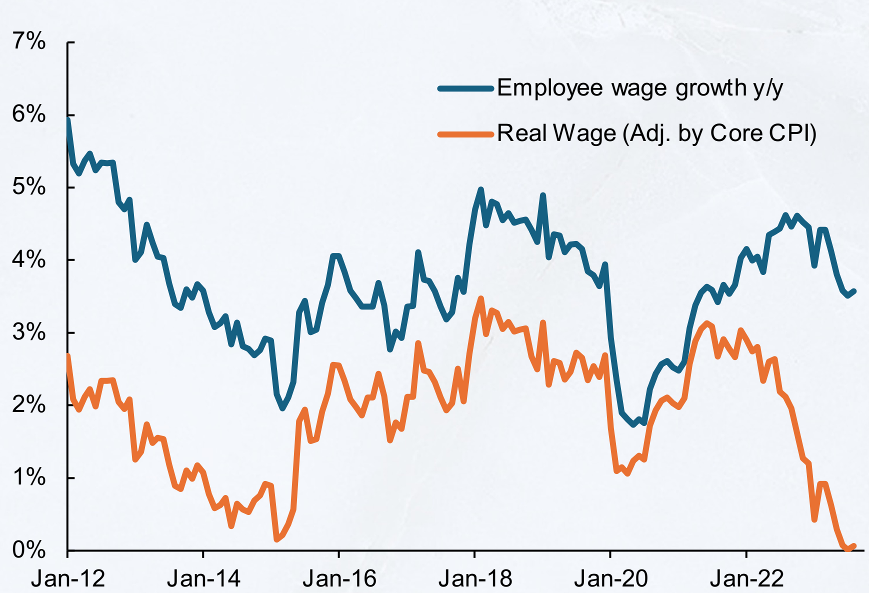
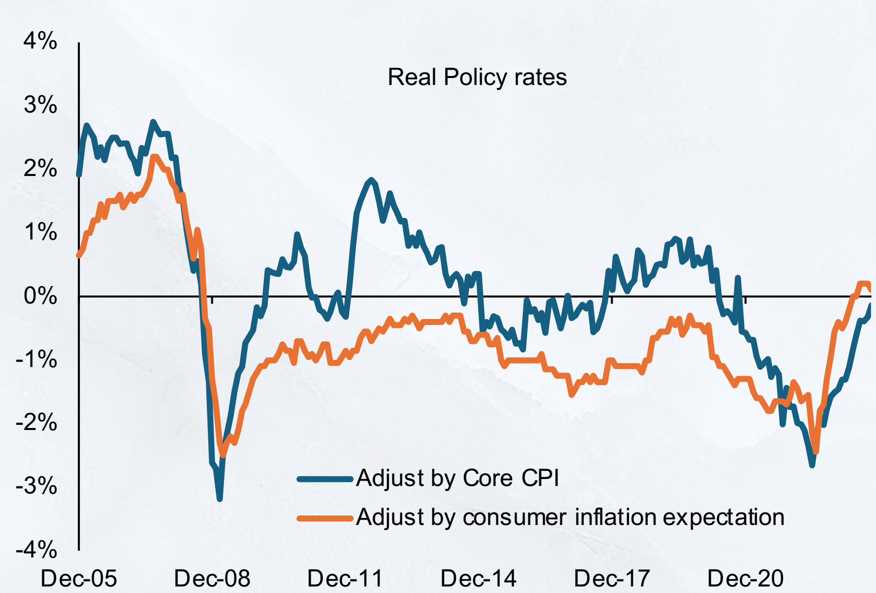


Fig. 10: Real rates have surged in past 1y



South Korea: BoP offer strong buffer to USDKRW

September current account surplus widened to USD5.5bn, from USD5.0bn in August (revised up from USD4.8bn). The goods surplus increased to USD7.4bn, from USD5.2bn in August, as we saw customs exports improving more than expected in September. Meanwhile, the financial account saw a smaller net outflow of USD4.5bn, from USD5.8bn in August. That said, reserve assets still declined by USD1.2bn in September, albeit slightly less than the USD1.6bn in August.

While downside risks remains from volatile crude oil prices, we believe the relatively large current account surplus should help contain KRW volatility and buffer against sharp depreciation risks in KRW. This resonates with the BoK's recent blogpost that despite higher-for-longer rhetoric, FX volatility should not be excessive. Meanwhile, the US Treasury's decision to drop Korea from its currency watchlist could also be supportive of KRW in short-term from sentiment channel, reinforcing the BoK's view. We believe such fundamental improvements should ease BoK concerns about FX pressures, allowing policy makers to focus more on domestic demand.

Fig. 11: Current account surplus underpinned by goods surplus

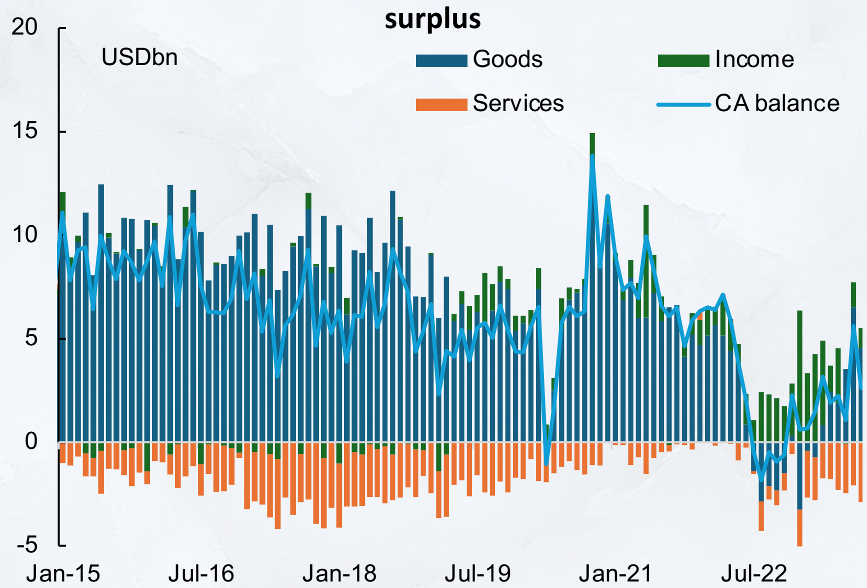


Fig. 12: Capital outflows persist on portfolio investment

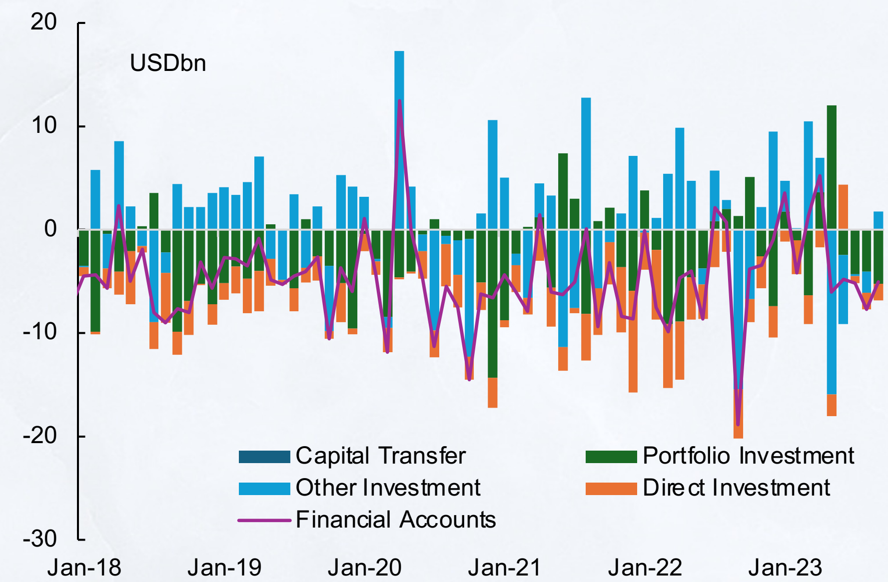


Fig. 13: Tourist net outflows reduced

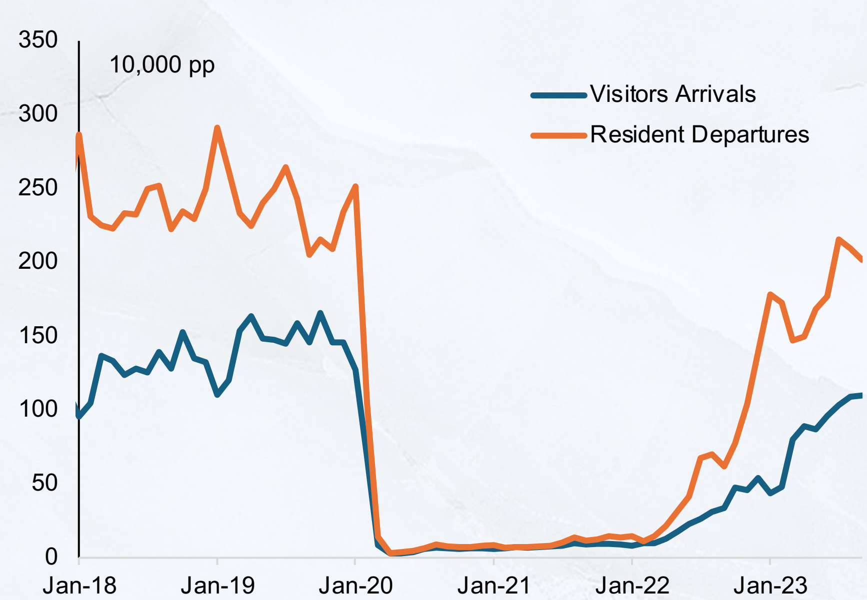


Fig. 14: Income flows remain supportive

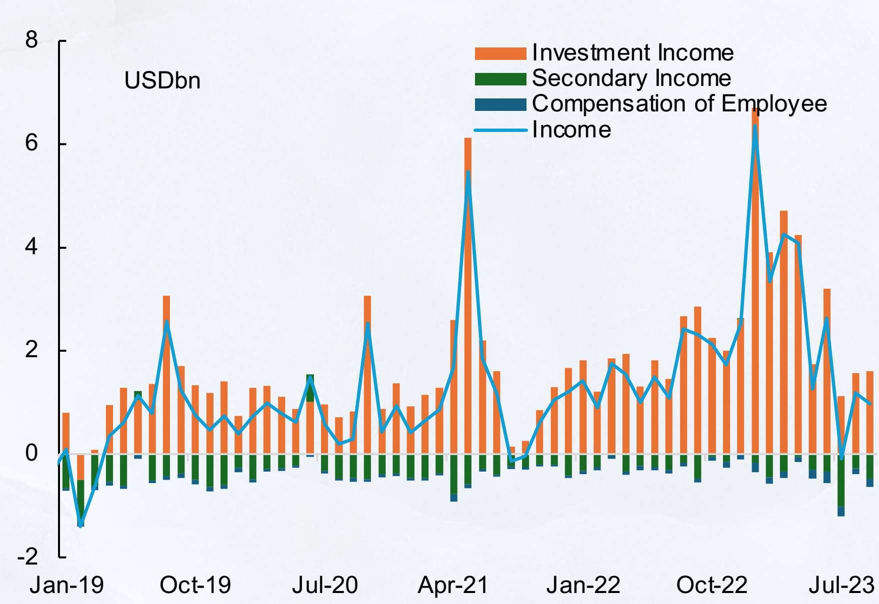


Fig. 15: NPS is still the biggest player in portfolio outflows

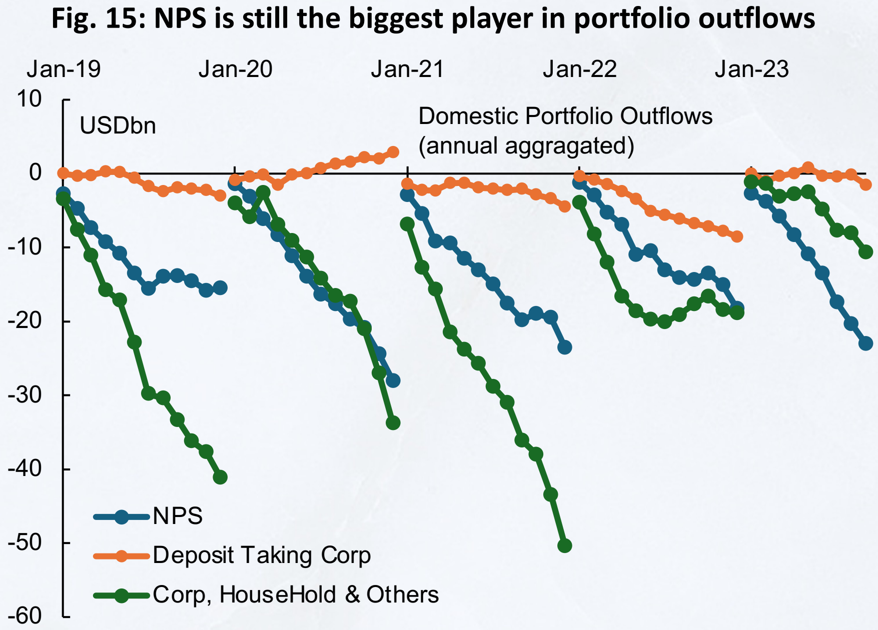
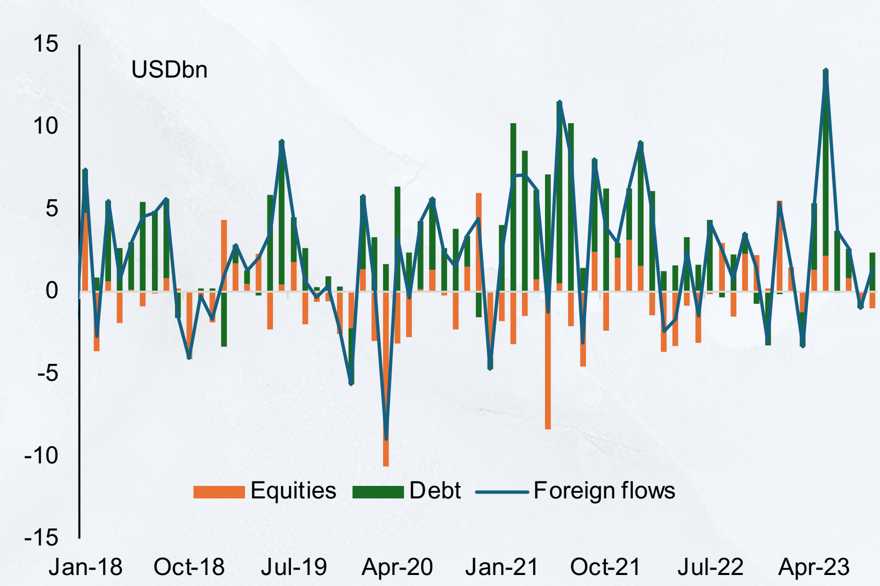


Fig. 16: Foreigners returned to fixed income markets



Taiwan: Sluggish external demand continue to weigh on domestic economy

October exports missed consensus as non-tech exports slipped. We track relatively steady tech exports, and this is likely to continue. October CPI inflation came in slightly higher than consensus. We believe the CBC will stand pat and let the TWD depreciate gradually to support exports as core inflation likely softens.

Exports slipped after registering the first growth in y/y terms in September, falling 4.5% y/y (BBG consensus: 0.0% y/y, Sep: +3.4%, **Fig. 17**). This marked a decent miss versus consensus for a flattish print. We saw relatively steady momentum for both tech and non-tech segments in past two months, but Non-tech exports reversed their solid trend from the past two months, declining 8.6% m/m sa, versus gains of 2.5% in September and 10.9% in August. The slowdown was relatively broad based with exports falling in most of the categories includes chemicals, textiles, plastic and rubber materials, and base metals.

Meanwhile, tech exports remained in a growth trend as we expect relatively solid tailwinds from Chinese smartphone demand & robust demand on HPC sector. Despite 1.8% decline in electronics components exports, ICT exports continued to rise, increasing 2.5% m/m sa, on top of the 9.5% increase in September. While new iPhone 15 sales seemed to have been soft, new smartphone model launches in China and relatively solid demand led exports to China to rise 8.9% m/m sa in October (Sep: +5.2%).

Despite softer-than-expected exports, we believe Taiwan's exports are likely to continue recover into November and December. While we believe Taiwan's semiconductor exports recovery likely lags that of Korea in this cycle, decent tailwinds from smartphone demand in next quarter or two should give some cushion against weakness in non-tech exports, in our view.

In the meantime, October CPI inflation picked up to 3.05% y/y (**Fig. 18**), above the Bloomberg consensus of 2.8%, but in line with the spike on commodity price. While the headline CPI print continued to accelerate, core inflation – excluding fruit, vegetables and energy – remained broadly unchanged at 2.49% versus 2.48% in September.

With the relatively anchored Core CPI, we retain our view of CBC keeping its policy rate unchanged in coming MPC meeting and support the economy. Furthermore, both monetary and property-related indicators also suggest a less urgent need to change the monetary policy stance. September daily M2 growth slowed to 5.98% and is now within the target band of 2-6%. The softening in national property prices also suggest to the central bank that macroprudential measures are more effective of curbing financial imbalances than direct tightening.

Against the backdrop, we believe CBC's policy direction would be holding policy rates while allowing TWD to further weaken to boost the export growth and competency. As TWD is still trading far from the 95% of NEER 3yma (reference lower band from CBC), there should be some room for TWD depreciation, even though USDTWD has been trading around the 7y high. Hence, we still like carry trade funded by New Taiwan dollar like short TWDIDR. TWDPHP.

Fig. 17: Non-tech exports drag the growth back to contraction

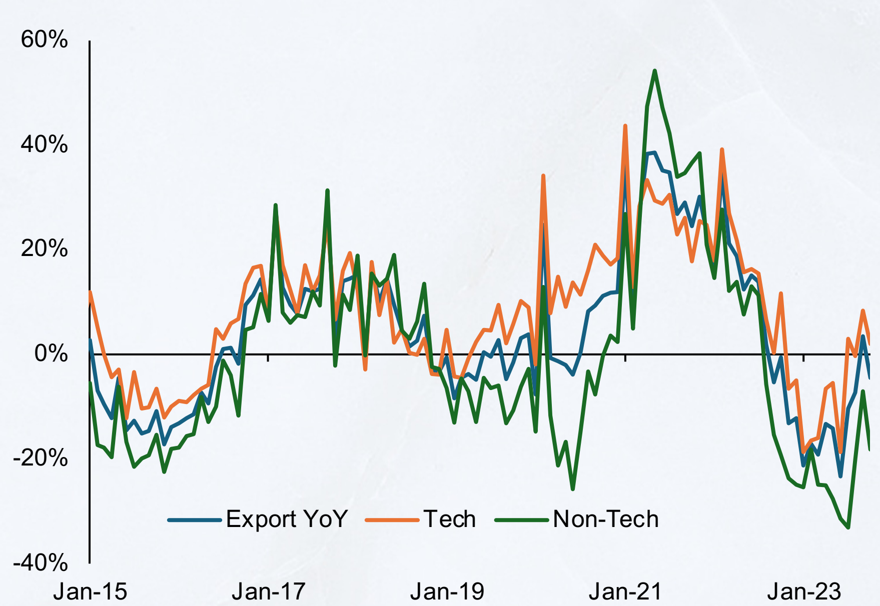
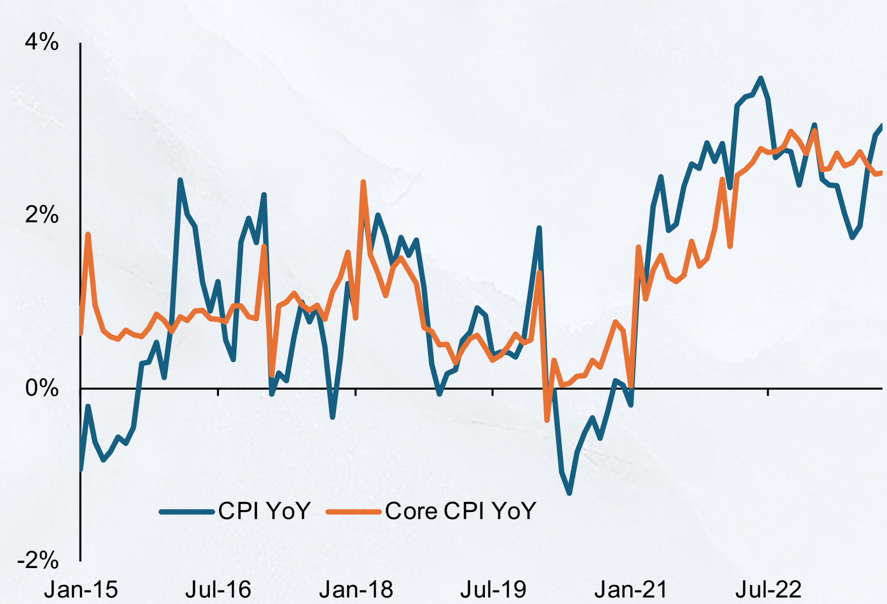


Fig. 18: Core CPI still in moderating trend



Indonesia: Some respite for the BI

GDP growth slowed to 4.9% y/y in Q3 (**Fig. 19**), marking a 0.3ppt deceleration from 5.2% y/y in Q2. This was the first time in 2 years that growth was sub-5% and below consensus forecasts.

Consumption slowed sharply. Real private consumption, which rose by just 0.2% q/q sa (5.1% y/y). This was the weakest q-o-q growth rate in two years. Consumer sentiment indicators have been flashing "red" for lower-income consumers, consistent with lingering post-pandemic effects such as high informal employment and weak real wage growth. The semi-annual labour market data showed the unemployment rate fell back to 5.3% in August 2023 (from 5.5% in February) but remains above the pre-pandemic average. Wage growth picked up modestly to 3.5% y/y, compared to 1.8% in February.

Real export growth remains negative on a y/y basis but improved sequentially. We expect headwinds to real export volumes to remain, amidst likely weaker global growth next year. Real goods exports stabilized, rising 0.7% q/q sa after a cumulative 8.5% drop from the Q4 2022 peak. With services exports doing better (up 10% q/q sa due to increased tourism support), and tepid import demand (+0.2% q/q sa), the net export contribution to y/y growth improved slightly to 0.2ppt (from a net 0.1ppt drag in Q2), albeit still a step-down from last year.

Machinery investment was weak (-0.7% q/q sa, -1% y/y). Underperformed sectors included real estate, utility, info & comm, and wholesale & retail trade. The construction sector grew by +1.4% q/q sa (6.4% y/y), a relative outperformer, while the manufacturing sector picked up pace, expanded by +1.7% q/q sa (5.3% y/y). That said, Post GDP release, Indonesia's finance minister highlighted mitigation efforts by the government to support growth, including rice aid and a 100% VAT incentive for the housing sector.

Moreover, recent stabilization of IDR would likely alleviate Bank Indonesia's (BI) burden and further lower the need for another tightening move. Spot USDIDR is now far from its peak 15690 (**Fig. 20**), and we believe BI to take the opportunity to refrain from another hike, especially with Q3 GDP growth slowing. That said, we remain cautious of renewed IDR volatility, especially as US economy is now on idiosyncratic pace. If the Federal reserve deliver another 25bp hike in December with resilient growth momentum, we won't exclude the possibility for BI to conduct a follow-up 25bp hike in January.

Last but not least, 205m Indonesians will vote for their new president after 10 years Jokowi presidency at 14 Feb 2024. With large-scale Presidential and legislative elections due next year, and a better-than-expected fiscal trajectory this year, this means both willingness and opportunity to enact a slightly more progressive fiscal stance, with hints of changing priorities clear from the 2024 Budget. Even so, we are cautious on the consumption recovery in the near term.

Fig. 19: Indonesia GDP Growth & sector breakdown

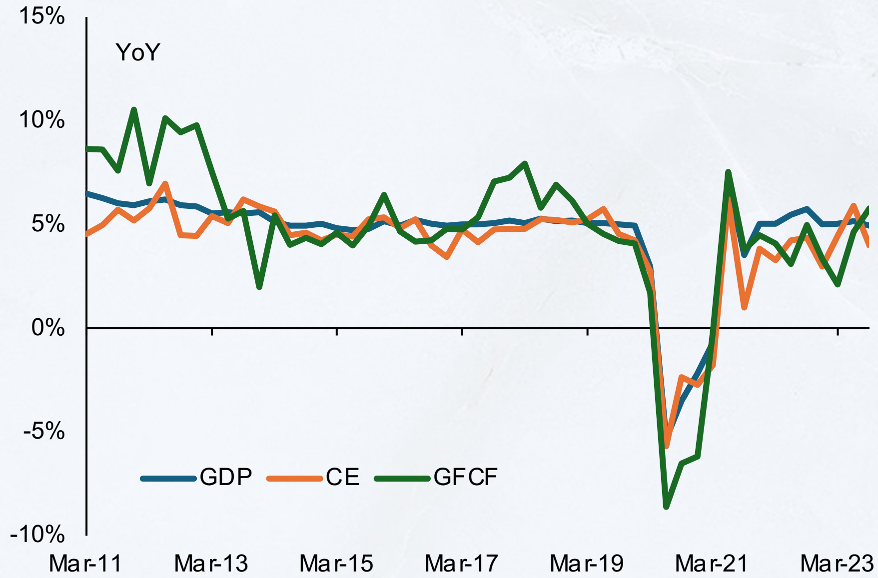


Fig. 20: Lower USDIDR reduce the need for further tightening

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