CUIRS INVESTMENT RESEARCH

15 October 2023

Global Market Wrap-up

Turbulent world with another tension

Multi-assets

Global

- Israel-Hamas War broke out on October 7-8th, which added another uncertainty to the world that is already geopolitically tense and economically vulnerable.
- Economic data this week generally pointed to upside risk to inflation and downside risk to growth due to resurgence in oil price even before the war and effects of rate hikes.
- DM central banks except BoJ continue evaluating risks from the effect caused by their tightening cycles. Dollar strength and idiosyncratic inflation risks led to different policy stances among EM policymakers.

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CUIRS Insight

Flight to safety and dovish Fed commentaries led to reversal in US yields. Long-term treasury selloff, caused by higher-for-longer talks in September FOMC and supply-demand imbalance in treasury issuance, has stabilized when investors are once again seeking safe-haven assets. Federal Reserve officials also expressed concerns about the economic impact of surging long yields and signaled the possibility of no additional hike in the following meetings. UST 10Y yield closed at 4.61%, down from the peak of 4.8% earlier this month.

Improved risk sentiment is seen in China equities. It is reported that the central government is considering budget revision to allow additional RMB1trn bond issuance for infrastructure expenditures. While the scale is just at 0.8% of GDP, this could signal a policy shift from relying on local government leverage to central government leverage in stimulating the economy, given its much healthier balance sheet and lower borrowing costs. However, weak CPI data on Friday could retrigger deflationary concern and the recovery still appears rocky. In our view, The RMB1trn bond issuance should help little on achieving 2023 GDP growth target of 5% given there's no much time left.

In Europe, the latest data simply imply the stagflation narrative has not faded. UK GDP rebounded mildly from the strike-afflicted July, yet manufacturing and construction contracted more than expected, while Germany revised its growth forecast downwards due to energy prices and China slowdown.

In Asia, Japan is still tolerant of transitory inflation to juice growth. IMF raised Japan's growth and inflation outlook due to both domestic and external demand. BoJ is also patient in maintaining accommodative given inflation has yet driven sustainable wage growth. Inflation outlook is also benign in Korea, with headline CPI expected to return to 2% next year and BoK expected to keep rate on hold in the meeting next week. We anticipate BoK to remain hawkish tone and start to cut in 2024Q2, however the risk tilts to later start.

Source: Bloomberg, CEIC, CUIRS

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US: yield rally halted by dovish talks and Israel-Hamas war

Surge in long yields finally saw signs of stabilizing after US30Y reached 5% for the first time since 2007. Several events have been driving movements in US rates:

- **Dovish Commentaries**: Federal Reserve officials downplayed the necessity of additional rate hikes as they were monitoring the recent yield rally. They agreed that tightening in financial conditions may effectively substitute for additional hikes, and they appeared patient in assessing its impact on the economy even though inflation stays high, since they need to balance the risks of under-tightening against over-tightening. As of 13th October, federal funds futures have priced in 70% probability of staying at the current 5.25%-5.50%.

- **Israel-Hamas War**: Israel-Hamas war prompted a flight to safety as investors weighed the economic impact of the war. Yields also retraced on Friday when Israel signaled a potential ground invasion of the Gaza Strip with its evacuation order.

- **Sticky Inflation Prints**: On the upside, rates were still moved by reignited inflation. PPI and CPI releases were both higher than estimates. PPI rose 2.2% YoY (1.6% expected) and core PPI rose 2.7% YoY (2.3% expected). CPI rose 3.7% YoY (3.6% expected) and core CPI rose 4.1% YoY (4.1% expected). Energy inflation led by higher fuel oil prices remains the major uncertainty to disinflation progress. Among core items, shelter inflation stays elevated at 0.6% MoM and 7.2% YoY, though housing statistics are known to be lagged, since it includes all leases in force instead of only those signed in September.

Fig. 1: Treasuries stabilized after a month of selloff

Fig. 2: Excerpt from Federal Reserve officials' commentaries

Officials	Commentaries
Vice Chair Philip Jefferson	Increase in treasury yields as a potential further restraint on the economy
Bank of Dallas President Lorie Logan	Recent surge in long yields may mean less need to raise rate
Vice Chair for Supervision Michael Barr	Labor supply and labor demand are coming into better balance
Bank of New York President John Williams	We are at, or near, the peak level of the target range
Bank of San Francisco President Mary Daly	5% is not going to be the new neutral…anywhere between 2.5 and 3 as the nominal neutral

Fig. 3: CPI ex shelter is reaching Fed's target

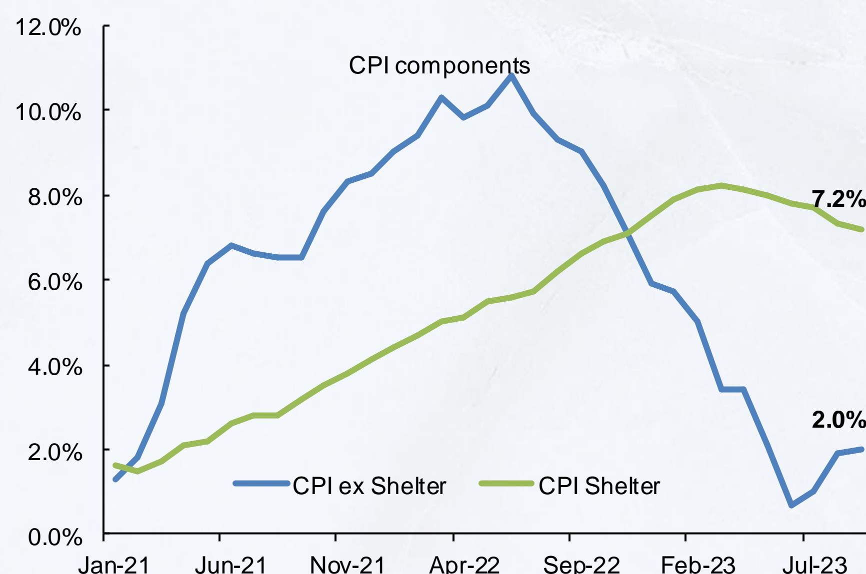
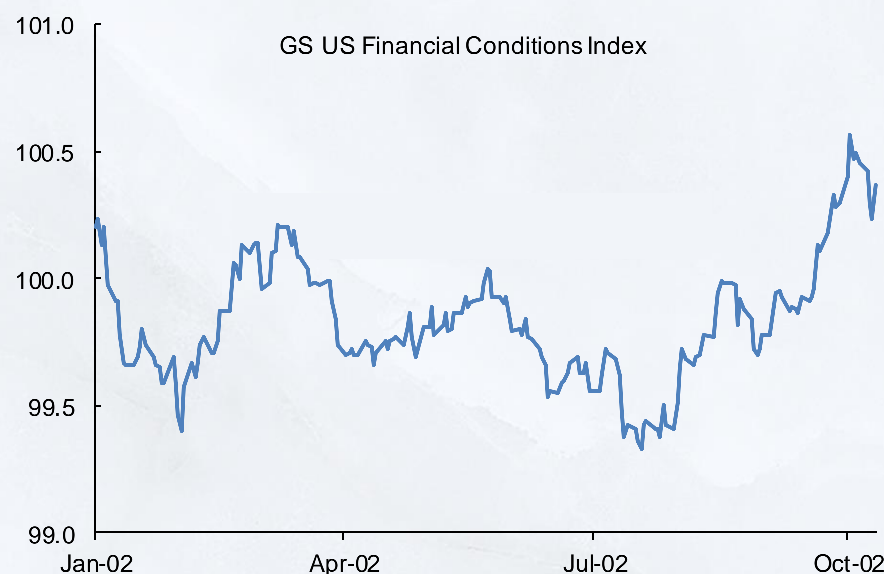


Fig. 4: Financial conditions further tightened since banking crisis



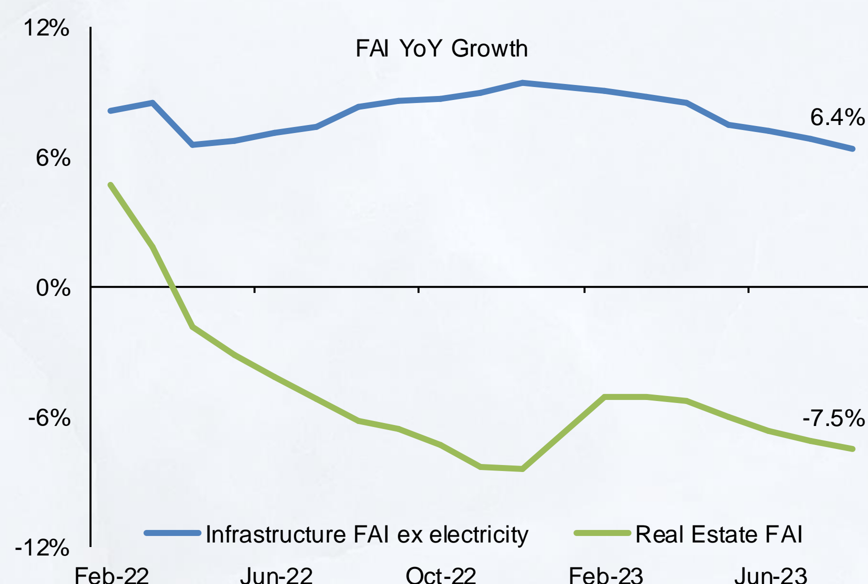
China: equities rebounded on fiscal stimulus bets

Central government is considering the issuance of at least RMB1trn (0.8% of GDP) of additional sovereign debt for infrastructure spendings, according to Bloomberg sources. This aims to stimulate the economy to meet the official growth target of 5%, which was viewed conservative back in March. The special issuance could raise this year's budget deficit to above the 3% cap set in March, and it would still need to be approved by NPCSC that is expected to meet at the end of the month. After the news release, CGB faced some sell-off given the concern on increasing supply, however the yield was pushed lower after Thursday.

Back in September, the central government already launched a RMB1.5trn LGFV swap program, that allows provincial governments to swap the LGFV debt and other off-balance sheet borrowings into provincial debt at lower interest rates and longer maturities. This, combined with the infrastructure stimulus, could signal how central government is taking up more fiscal responsibilities when local authorities have run out of room to leverage. This could also offset the decline in FAI (Fixed Assets Investment) in real estate with more investment in infrastructure, such as water conservancy projects, given the property market remains sluggish.

Fig. 5: The streak of gains ended by weak data

Fig. 6: Infrastructure to offset property weakness



The macro data releases on Friday, however, still pointed to a modest recovery. CPI is 0.0% YoY (0.2% expected), again at the brink of deflation. PPI deflation, though improved from the previous months, is still down 2.5% YoY (down 2.4% expected). The Golden Week spending data also underscores weak domestic consumption, with tourism spending only up 1.5% from 2019's Golden Week (meaning lower real spending if inflation adjusted). While domestic demand is weak, exports (-6.2% vs -7.6% expected) and TSF (4,120B vs 3,800B expected) data are better than estimates.

Home sales also struggled to make a turnaround. Despite a series of stimulus, including down-payment cut and easing purchase restrictions, total sales at the 100 largest developers in September still dropped 29% YoY, while average daily sales in 35 cities dropped 17% YoY in the holiday period, with smallest cities performing the worst. Country Garden also signaled on Tuesday that it does not expect to be able to repay all its offshore debt, after its September contracted sales being down 81% YoY, which hints sustained property weakness and calls for more stimulus to better restore confidence and boost purchasing power.

We remain our view on China FX and rates, which is a tug of war now. USDRMB performs relatively stable with FX measures continuously in effect, including stronger USDCNY fixing, tight CNH liquidity, etc. Furthermore, the easing tension between US and China also offers RMB some respite now. With year-end seasonality (corporate repatriation flows), we forecast USDRMB to slightly move back to 7.20 level in 2023YE. Given the risk of more RRR and policy rates cut, the market seems not interested in outright pay rates. With that bear in mind, we still like steepener trade, but admittedly market needs more active signals from the government to regain confidence first. (See *China: Exploring the valley*, Sep 29th 2023)

UK: stagnation risks remain

UK released major economic data on Thursday. Its GDP grew at 0.2% MoM, in line with expectation. The recovery, however, is mostly a rebound from July when strikes and other large-scale industrial actions took place. Among the sectors, services grew 0.4% MoM as teachers returned from strike, but manufacturing and construction contracted by 0.8% and 0.5%, worse than down 0.4% and up 0.2% respectively.

Inflation, higher taxes and lagged effects of cumulative rate hikes continue weighing on consumer demand and business activities. BoE's quarterly credit conditions survey found that mortgage supply lowered in 3Q and will be further restricted in the coming months. Defaults and losses on home loans picked up in 3Q as more households have to refinance at higher rates, while demand for unsecured lending, including credit cards, is also expected to climb in the coming months. As financial conditions tighten and household balance sheets deteriorate, IMF predicts UK will place last for growth among G7 in 2024, at a modest pace of 0.6%. GBPUSD closed at 1.2139, down 0.8% this week and 7.6% from the peak in July.

With ongoing tension in middle-east, we believe the risk-off sentiment will bring GBPUSD back to test 1.2073 (61.8% Fibonacci level) next week. Any underperforming domestic econ data in UK will again drag sterling down (against the greenback), and it should re-test the 1.18 level if the tension get more intense.

Euro Area: parity back in play

Industrial production in Eurozone expanded 0.6% MoM in August, better than 0.1% expected, yet mostly driven by smaller member states such as Slovakia, Denmark and Malta. Growth in biggest economies remained concerning, with German government revising its growth forecast downward to a contraction of 0.4% this year (expansion of 0.4% forecasted in spring) and a weaker-than-expected recovery of 1.3% next year (1.6% forecasted in spring). The lingering effects of energy crisis, rising borrowing costs and China slowdown are major factors dragging down German growth. Concerns about Italy's bloated government debt load, with debt-to-GDP and deficit-to-GDP expected to be stuck at 140% and 5% respectively, combined with the revived energy prices are also domestic factors driving Euro depreciation.

Same as Sterling, Euro should continue to weaken given the carry disadvantages and energy concern, we still like EUR as a funder, and recommend trade like short EUR versus some currencies that offer higher rates or are influenced less by Israel-Hamas war like CAD, MXN and BRL.

Fig. 7: Euro and Pound depreciated from July high, due to both higher US yields and domestic weakness

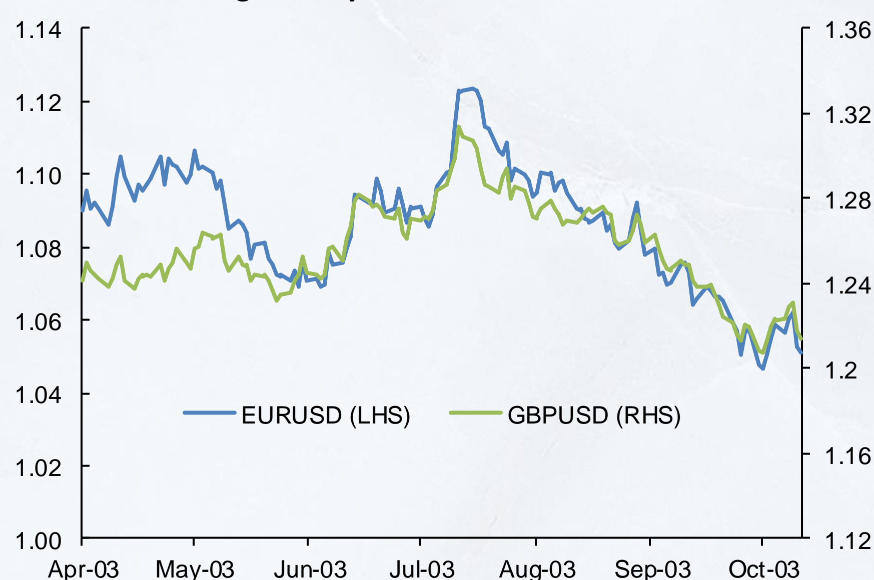


Fig. 8: IMF forecasts for G7 growth

Countries	2023 GDP YoY	2024 GDP YoY
US	2.1	1.5
Canada	1.3	1.6
Japan	2.0	1.0
UK	**0.5**	**0.6**
France	1.0	1.3
Germany	**-0.5**	**0.9**
Italy	**0.7**	**0.7**

Japan: BoJ remained patient in assessing inflationary prospect

IMF raised Japan's growth and inflation outlook, forecasting a 2% growth (from 1.4% forecasted in July) due to pent-up consumption, surge in inbound tourism and auto exports, and a 3.2% inflation (from 2.7% forecasted in April). IMF expects Japan to lead G7 for growth in per capita GDP in 2024. BoJ is also expected to raise inflation outlook from 2.5% in July to near 3% at its next meeting on Oct 30th-31st, according to Kyoto News sources.

Despite higher inflation estimates, Japan's CGPI (Corporate Goods Price Index), a measure of producer prices, fell to 2% in the latest print, which is below estimate of 2.4% and also the slowest reading since March 2021. It supports BoJ's view that import-driven inflation is moderating and officials still need more evidence that inflation is sustainably above their target of 2%. BoJ member Asahi Noguchi commented there is no rush to adjust policy for the time being, and BoJ is still some distance from achieving its price goal. He also reiterated BoJ's focus on wage growth target of near 3%. All these signaled that while scrapping negative policy rate and exiting YCC are widely expected, they are still not imminent. 10Y JGB closed at 0.76% on Friday.

With BoJ official's dovish tone on monetary policy shift, we continue to see short Yen position being built at around 150, while those build above 150 are light compared to the position below. 150 seems to be hard line for USDJPY, this is especially true if we consider the early-Oct drop in NY trading time as authority's intervention. Though both BoJ and MoF didn't admit that they intervene, but the market suspect that the sharp drop was caused by verbal intervention or window guidance (*Bloomberg*, Oct 4th 2023), this also suggest that market is more nervous when reaching last year high. The hedging need recently provides buffer for Yen, but the huge rates differentials with US should continue to push USDJPY higher, even if the official interventions step in.

South Korea: electronics led equity gains

Samsung reported earnings on Wednesday. 78% decline in operating income (2,400 billion won) in Q3 appears better than feared, compared to 95% operating income plunge (to 670 billion won) in Q2, and also signals signs of bottoming out in semiconductor market. Samsung is often considered a bellwether for the tech industry due to its leading position in chips, electronics and smartphones. BoK governor Rhee Chang-yong also said on Wednesday that semiconductor prices are hitting the bottom and conveyed his hope that recovering technological exports could fuel economic growth next year. Throughout the week, Samsung and KOSPI were up 3.03% and 1.97% respectively. The already bottom-out and improving DRAM cycle offer fundamental support to KRW. That said, the high beta with DXY and energy net importer status, we remain slightly bullish on KRW, RV trade like short TWDKRW looks more attractive to engage the KRW fundamental improvement.

Regarding rates, while Rhee reiterated his focus on inflation, he also noted Korea's core inflation remained unchanged at 3.3% for three months in a row. Headline inflation, reported a higher-than-expected 3.7% due to oil spikes in September, was forecasted to converge to the 2% target next year. Hence, we expect policy rate unchanged at 3.5% at the MPC next week with a hawkish bias.

Fig. 9: Easing production inflation and below-target pay growth could postpone exit of YCC

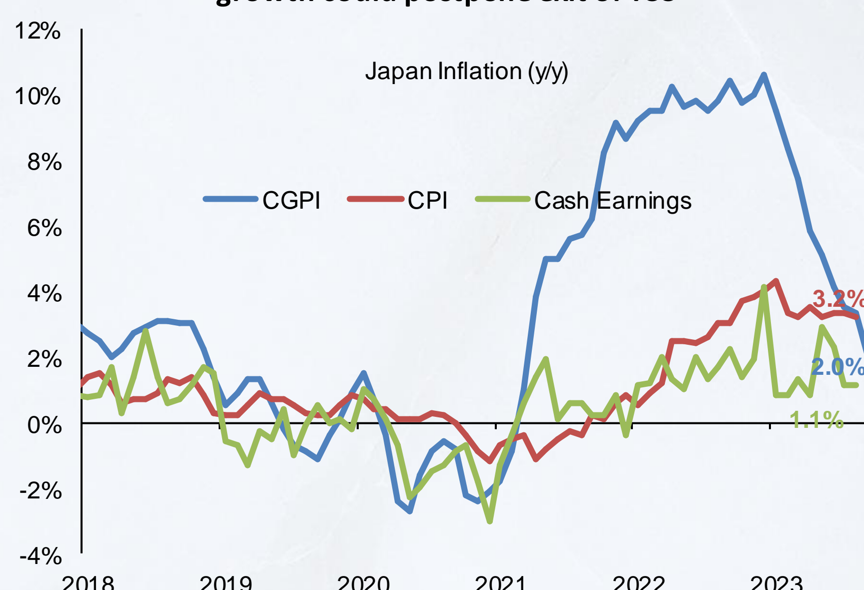
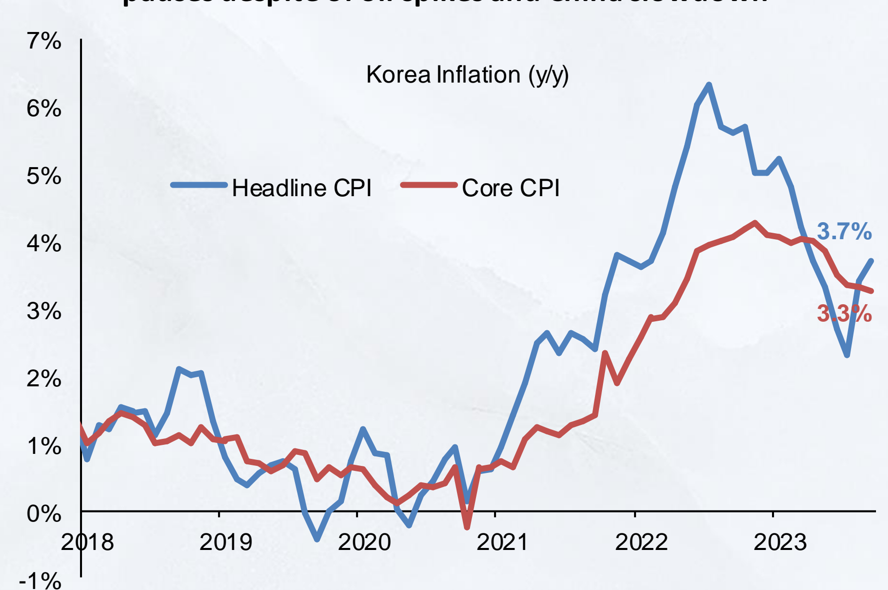


Fig. 10: Moderating core inflation allows BoK to continue pauses despite of oil spikes and China slowdown



EM Asia: Intact growth momentum but worrying inflation

Vietnam

Q3 GDP rose by 5.3% YoY (above 5% expected) and 3.0% QoQ, with growth momentum continued from 3.1% in Q2. Exports gained 6.0% MoM, with the largest contribution from textile, clothing and food. For industrial activities, contribution from sequential Gross Value Added (GVA) growth was the largest, which accelerated to 4.6%. Services growth also accelerated to 2.5%, led by lodging, art & entertainment and business administration. Conversely, agriculture and construction activities slowed.

Headline inflation surged to 3.7% from 3.0% in the previous month, the highest since February, though still below the central bank's target of 4.5%. Major contributors include food and service. Core inflation moderated to 3.8% YoY from 4.0% in the previous month. The market is expecting inflation to stay at 3.7% in 2023 and 3.5% in 2024.

Taiwan

After falling into contraction since Aug 2022, Taiwan's exports registered first growth (3.3% y/y). Tech exports continue to recover steadily, and we see significantly strong growth in information and communication products (59.8% y/y) thanks to the AI frenzy. Moreover, the non-tech exports also extend the increasing trend we see in August. To conclude, we are already left the trough of electronic cycle with more restocking on components for smartphones, this also suggest more fundamental supports for both TWD and KRW.

Thailand

Despite slowdown in Chinese tourism and export demand, Thai growth is expected to stay resilient at 4.2% in 2024 with supportive fiscal and monetary policies. The Pheu Thai Party announced a THB 10,000 digital cash payout to all Thai citizens aged 16 and above to stimulate consumption, which would cost THB560bn (3% of GDP).

India's recent restrictions on its rice exports have led to more than 20% increase in rice export prices. Sustained rice price increases, coupled with the digital cash payout, could trigger inflationary pressure. Thai government, hence, also promised on disinflationary policies, including reduction in energy prices and cutting train fares by more than half. Inflation is expected to rise yet kept within BoT's 1-3% target band.

Indonesia

Indonesia's headline CPI inflation fell to 2.3% YoY in September, down from 3.3% in August, mainly driven by favourable base effects as the subsidized fuel price hike from a year ago dropped out of YoY calculations. Bank Indonesia kept policy rate on hold in September, yet expected to cut soon as inflation has stayed in its target band for several months. However, BI also noticed the recent dollar strength, and stressed that the current policy focus is defending Rupiah stability, which may postpone the upcoming rate cuts.

India

India's headline CPI inflation fell to 5.0% YoY in September, down from 6.8% in August and lower than estimates of 5.5%, returning to 2%-6% target band of RBI. The government has taken a series of measures to curb inflation, including imposing curbs on exports of rice, wheat and sugar to combat food inflation (food prices also make up about half of the inflation basket). However, as demand remains resilient illustrated by surge in manufacturing production (10.3% YoY in August, also above estimates of 9.0%), RBI is expected to stay higher for longer until 2024 2H.

Singapore

Monetary Authority of Singapore (MAS) chose to keep monetary policy (SGD NEER mid-point, slope, and width) unchanged for inflation uncertainties. They also shift to quarterly meeting from bi-annual meeting, which aims to increase central bank transparency given the increasing complexity in formulating policy, in our view. We don't expect MAS to kick off easing cycle before 2024 Q2.

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