Global economy gets a helping hand from the Fed and China

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- *Due to yield compression and equity rebound, financial conditions worldwide are back to where they were during the exuberant days of Aug/Sept last year*
- *The Fed cemented its dovish tilt this week*
- *We are reading a signal with major implication from the Fed-- over the near term it may well take a relaxed view about inflation; this could cause the yield curve to bull steepen eventually*
- *US dollar may lack the strong tailwind of 2018, but we don't see sustained dollar weakness ahead*
- *China stimulus has helped sentiments to bottom in commodities and shipping*
- *Credit conditions remain strong, and with G3 central banks supporting liquidity, we will consider any see near-term selloffs as buying opportunities*

Dovish Fed and China stimulus to the rescue?

The sharp rebound seen in asset markets got another boost this week as the US FOMC cemented its dovish tilt. The US central bank has gone through a dramatic change of heart in about three months, which has been received exuberantly by global financial markets.

Financial conditions are back to where they were during the exuberant days of Aug/Sept last year, thanks to yield compression and surge in equities. Indeed, for the US, conditions are near the peak observed in history. For China, conditions have not gone back to their peak, but have improved sharply in recent months.

FOMC decision

Conventional wisdom in the markets used to be "don't fight the Fed." However, over the past decade or so, the US central bank has repeatedly scaled back its expectation of growth and inflation, and displayed acute sensitivity to the performance of asset markets. Perhaps the Fed now believes "don't fight the markets."

The March 20 FOMC decision reveals a bit more dovish view of the growth and inflation outlook, but they are not that material. After all, the economic projections are only 0.2% lower (2.1% vs 2.3% made in December) and even more modest for inflation (1.8% vs 1.9%). But between the line, we are picking up a more profound signal—which is that despite strong wage growth and rebounding commodity prices, the Fed will take a relaxed attitude if inflation were to pick up again. If true, this would mark a major departure in the monetary policy stance. We think that Fed communication will be increasingly focused on this area; having undershot its inflation target year after year, a bit of overshoot will be overlooked by the Fed in 2019 and 2020.

In our rates section, we consider the implication of this line of signalling. Right now, the fixed income market is rallying, but could the long-end eventually sell off as inflation bottoms, fiscal deficit remains large, and demand for long duration assets wane? We think this is quite possible, and not at all priced by the market.

Fed's dovish move extends beyond dot plots. Strikingly, the Fed has made clear that the pace of balance sheet normalisation will be slowed. The cap in monthly redemptions of treasury holdings will go to USD15bn beginning in May (from USD30bn). This and other tweaks will leave the Fed balance sheet steady at around USD3.5trln later this year.

These measures are going to provide crucial support to emerging markets, in our view. Liquidity conditions and cost of financing, both of which were sources of major headwind last year for EM rates and credit, will fade. But the eventual steepening of the US yield curve that we are envisaging could complicate the long-term funding picture eventually.

These market pleasing developments have fuelled rallies in EM assets already, but how sustainable is that? We note that both China and Europe have several idiosyncratic headwinds in play, which form negatives for their markets and economies. For China, these include the negative spill-over from its debt overhang and weak domestic sentiments. For Europe, they range from Brexit to complicated politics in France, Germany, Italy, and Spain. Hence, we are not expecting a sharp selloff in DXY.

We feel that Western central banks still do not fully appreciate the impact of China on their growth and inflation outlook. Perhaps the reaction function of policy makers should give higher weight to China's demand and price conditions, as they seem to be the best early warning indicators of the global cycle. With that mind, If the ongoing fiscal stimulus in China and positive developments in the China-US trade talks stabilise global demand and sentiments, the Fed may come across as having blinked too early.

Impact of China stimulus

Real economic data out of China remain poor, ranging from trade to PMI. Meanwhile, debt metrics keep worsening and sentiments are weak. But at the same time, expectations of largescale support for consumption (through incentives for purchasing white goods), firms (tax cuts), liquidity (through monetary easing), and investment (infrastructure spending) have risen. Combine this with the view that a China-US trade deal is around the corner, it is understandable why the market is ignoring the subdued data and looking forward instead.

A dash of realism may well be in the pipeline; trade negotiations can hit roadblocks, and stimulus measures can fail to achieve the desired results. Until that scenario transpires, global markets are taking a positive cue from China. Commodities have made a smart comeback this year, with oil up nearly 20%. This would help diffuse some of the fears of deflationary forces. Global shipping indices, which had nosedived late last year, have stabilised as well.

It is far too early to suggest that the Fed's dovish tilt and the China stimulus will create global reflation, but we are convinced that the authorities in China and the US are on the right track with their approaches. Some inflation and a resulting bull steepening could do this debt-laden world a lot of good.

Taimur Baig

FX: Fed's extended pause is not a bearish USD view

The Fed's decision at its FOMC meeting on March 20 to push out its next rate hike into 2020 was not an invitation to dump the US dollar. The Fed's announcement has been priced in, as evidenced by the fall in the US 10Y bond yield towards 2.50%, the ceiling of its Fed Funds target range. It was, however, reason enough for us to remove the two Fed hikes pencilled in 2H19. Hence, we have moderated our forecast in favour of a gentler USD climb over the next two quarters.

We consider the extended Fed pause a double-edged sword. On the one hand, emerging markets economies should be relieved that US rates are no longer rising this year, especially for countries that accumulate debt and run deficits to support growth. On the other hand, it warned of an increasingly synchronized global slowdown that could deteriorate further without deals to avert two pivotal risks i.e. US-China trade tensions and a disorderly Brexit. Both issues have been pushed out into 2Q19. It remains to be seen if US and China could resolve their differences for a trade deal. There is less optimism that the fractious UK government can rise to occasion to avoid crashing out of the EU in April-May without a deal. China's economic slowdown has also been elevated as a main threat to the global economy; growth is seen moderating towards the floor of its new official 6-6.5% growth forecast for 2019.

The drag on the USD from the Fed pause will be offset by other countries injecting liquidity into their financial systems. For example, The People's Bank of China has lowered banks' reserve requirement ratio (RRR) and left the door open for more cuts. Bangko Sentral ng Pilipinas intends to lower its RRR by 400 bps over four quarters. The Reserve Bank of India has lowered its repo rate by 25 bps to 6.25% and introduced the buy/sell USD/INR swap auction as a new tool to inject liquidity and support credit growth. The European Central Bank has announced new targeted longer-term refinancing operations (TLTROs). The Reserve Bank of Australia is under pressure to cut rates; AU 10Y bond yield fell below its official 2-3% inflation target this month. Against this background, we doubt that the Monetary Authority of Singapore will be looking to tighten its SGD NEER policy next month.

Philip Wee

Rates: Cementing the Fed's dovish pivot

The Fed unleashed another dovish surprise, cementing the dovish pivot that took place in December/January. While the policy rate was kept unchanged, the dot plot (here) now shows just one hike in 2020, compared to three (two in 2019 and one in 2020) back in December. Clearly, the Fed's focus has shifted towards supporting the economy and further normalisation is no longer a priority, hence an extended pause. **For all intents and purposes, an extended pause equals a stop in the tightening cycle** and USTs rallied across all tenors, with 10Y yields now hovering just above 2.50%. Meanwhile, the balance sheet runoff is set to slow (here) in May and will cease by September leaving the Fed's balance sheet at around USD3.5tn. There will also be tweaks in the composition of Fed holdings towards US Treasuries as principal payments from agency debt and MBS come in.

We think that USTs will be supported for the foreseeable future as the hurdle for another hike appears to be quite high. The market is even more aggressive and has fully priced in a 25bps cut by mid-2020. Accordingly, we have adjusted our forecasts and anticipate the Fed to stay on hold through to end-2020. With developed markets leaning towards further easing, the situation is reminiscent of 2015/16 where the Fed was unable to hike as much as it wanted to. The timely and aggressive pivot from the Fed has eased financial conditions and should cushion the slowdown in the US economy. **Recession risks may start receding (leading to a steeper UST curve) as it becomes clear that the Fed stance is now tilted towards supporting the economy.**

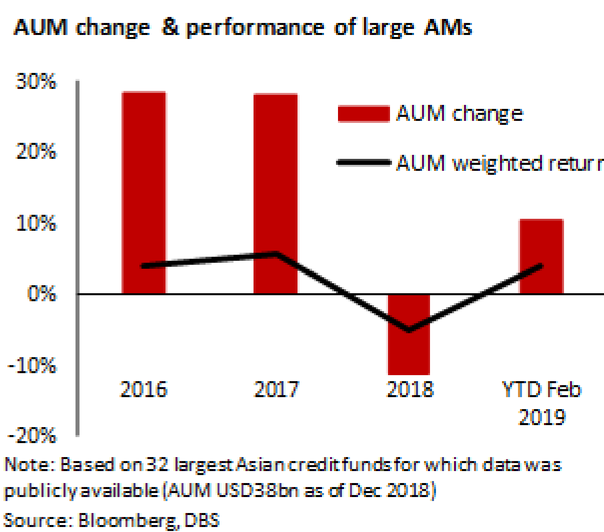
For Asia assets, the decline in USD rates is undeniably positive. High-yielding govvies (Indonesia, India and the Philippines) have had a good rally since the start of the year with possibly more to come. With the Fed signalling an extended pause, **rate cut bets should build across Asian economies,** especially those where real rates are still elevated (Indonesia, India, Philippines, Malaysia).

Running ideas:
-receive 10Y (or 5Y5Y) SGD swap vs pay 10Y (or 5Y5Y) USD swap (12th Mar)

Eugene Leow

Asian Credit: All about momentum and technicals

Asian credit markets remain strong and grind tighter. With valuations getting rich, a pullback should be on the cards, but we see no immediate catalyst. In the absence of any major global risk events, we believe any pull back will be small and an opportunity to add risk. This is because technicals remain strong, especially the amount of liquidity looking for yield with central bank policy expected to be favourable globally. Event risks have also generally been positive lately (e.g. news of equity raising by companies, asset divestment), which has further supported sentiment in the high yield space. In the Macro Strategy dated 8 March, we had elaborated on the support for valuations coming from liquidity in the system by citing the strong order books in the primary market, a trend that continues to hold. Another indicator that we have looked at in the past is the assets under management (AUM) of leading funds. A sample of 32 large Asian credit funds (aggregate AUM of USD43bn as of February 2019) shows that the AUM of the sample showed strong growth in the first two months of 2019 (+10.6% non-annualised), reversing the decline seen in 2018. The strong demand for bonds (for example in primary issues) is supported by this funds flow data. We note that the funds have also reported strong performance (+4% non-annualised return), in line with market performance this year. That said, returns for the rest of the year are likely to be less robust, coming mainly from coupon carry rather than capital appreciation as seen so far this year.



Note: Based on 32 largest Asian credit funds for which data was publicly available (AUM USD38bn as of Dec 2018)
Source: Bloomberg, DBS

While markets remain well supported in the near-term, risks for a pullback remain. The key events to watch out for would be potential changes to Fed policy and setback in US-China trade discussion. We see markets having left little room for error on both (i.e. pricing in a dovish Fed and a favourable trade outcome). Specific to credits, we see the risk as lower. While incidents of liquidity stress are rising, the impact is localised and there are no systemic concerns for now. If anything, a key issue to monitor would be Chinese government's policy towards credit conditions, which can have a significant impact on access to funds for high yield issuers. We expect credit conditions to be supportive for now, given concerns over domestic growth.

Neel Gopalakrishnan

Highlights of the week:

Thailand: Elections a bigger watch factor than rate review
India's trade deficit with China has improved
Thailand: THB seasonality to flip
Chart of the Week: Fed vs Markets

Key Forecasts

	GDP growth, % YoY				CPI inflation, % YoY, ave			
	2017	2018e	2019f	2020f	2017	2018e	2019f	2020f
China	6.9	6.6	6.2	6.0	1.6	2.1	2.3	2.3
Hong Kong	3.8	3.3	2.5	2.0	1.5	2.5	2.7	2.5
India*	7.1	6.7	7.1	7.4	4.5	3.6	3.5	3.8
Indonesia	5.1	5.2	5.2	5.1	3.8	3.2	3.6	3.6
Malaysia	5.9	4.7	4.5	4.2	3.8	1.0	1.7	1.6
Philippines**	6.7	6.3	6.5	6.4	2.9	5.2	3.9	3.8
Singapore	3.9	3.2	3.0	2.8	0.6	0.4	1.8	1.5
South Korea	3.1	2.7	2.6	2.4	1.9	1.5	1.1	1.5
Taiwan	3.1	2.6	1.9	1.8	0.6	1.3	0.7	1.0
Thailand	3.3	4.1	3.8	4.0	0.7	1.1	1.0	1.3
Vietnam	6.8	7.1	6.6	6.3	3.5	3.5	3.8	3.4
Eurozone	2.5	1.9	1.2	1.5	1.5	1.8	1.2	1.3
Japan	1.9	0.7	0.7	0.5	0.5	1.0	1.1	1.6
United States***	2.3	2.9	2.5	1.5	2.1	2.4	1.5	1.5

* refers to year ending March ** new CPI series *** eop for CPI inflation

	Policy interest rates, eop							
	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20
China*	4.35	4.35	4.35	4.35	4.35	4.35	4.35	4.35
India	6.25	6.00	6.00	6.00	6.00	6.00	6.00	6.00
Indonesia	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00
Malaysia	3.25	3.25	3.25	3.25	3.25	3.25	3.00	3.00
Philippines	4.75	4.75	4.75	4.75	4.75	4.75	4.75	4.75
Singapore**	1.95	1.95	1.95	1.95	1.95	1.95	1.95	1.95
South Korea	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75
Taiwan	1.38	1.38	1.38	1.38	1.38	1.38	1.38	1.38
Thailand	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75
Vietnam***	6.25	6.25	6.25	6.25	6.00	5.75	5.75	5.75
Eurozone	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Japan	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
United States	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50

* 1-yr lending rate; ** 3M SOR ; *** prime rate

	Exchange rates, eop							
	Mar 20	Q2 19	Q3 19	Q4 19	Q1 20	Q2 20	Q3 20	Q4 20
China	6.69	6.85	7.00	6.95	6.90	6.85	6.80	6.75
Hong Kong	7.85	7.85	7.85	7.84	7.83	7.82	7.81	7.80
India	68.6	70.0	71.0	71.5	71.0	70.5	70.0	69.5
Indonesia	14086	14300	14500	14400	14300	14200	14100	14000
Malaysia	4.06	4.10	4.20	4.25	4.20	4.15	4.10	4.05
Philippines	52.8	54.0	55.0	54.5	54.0	53.5	53.0	52.5
Singapore	1.35	1.37	1.40	1.39	1.38	1.37	1.36	1.35
South Korea	1126	1135	1145	1140	1135	1130	1125	1120
Thailand	31.7	32.5	33.0	32.8	32.6	32.4	32.2	32.0
Vietnam	23207	23250	23300	23280	23300	23250	23200	23150
Australia	0.71	0.70	0.68	0.68	0.68	0.69	0.70	0.71
Eurozone	1.14	1.12	1.10	1.11	1.12	1.13	1.14	1.15
Japan	111	113	115	114	113	112	111	110
United Kingdom	1.32	1.30	1.28	1.29	1.30	1.31	1.32	1.33

Australia, Eurozone and United Kingdom are direct quotes

		2019				2020			
		Q1	Q2	Q3	**Q4**	Q1	Q2	Q3	**Q4**
US	3m Libor	2.70	2.70	2.70	**2.70**	2.70	2.70	2.70	**2.70**
	2Y	2.45	2.45	2.50	**2.50**	2.50	2.50	2.50	**2.50**
	10Y	2.55	2.55	2.60	**2.65**	2.70	2.70	2.70	**2.70**
	10Y-2Y	10	10	10	**15**	20	20	20	**20**
Japan	3m Tibor	0.05	0.05	0.05	**0.05**	0.05	0.05	0.05	**0.05**
	2Y	-0.15	-0.15	-0.15	**-0.15**	-0.13	-0.10	-0.07	**-0.05**
	10Y	0.00	0.03	0.05	**0.07**	0.10	0.13	0.15	**0.15**
	10Y-2Y	15	18	20	**22**	23	23	22	**20**
Eurozone	3m Euribor	-0.30	-0.30	-0.30	**-0.30**	-0.30	-0.30	-0.30	**-0.30**
	2Y	-0.55	-0.55	-0.55	**-0.55**	-0.55	-0.55	-0.50	**-0.50**
	10Y	0.10	0.10	0.10	**0.10**	0.10	0.15	0.20	**0.25**
	10Y-2Y	65	65	65	**65**	65	70	70	**75**
Indonesia	3m Jibor	7.20	7.20	7.20	**7.20**	7.20	7.20	7.20	**7.20**
	2Y	7.00	6.90	6.80	**6.70**	6.70	6.70	6.70	**6.70**
	10Y	7.80	7.70	7.60	**7.50**	7.50	7.50	7.50	**7.50**
	10Y-2Y	80	80	80	**80**	80	80	80	**80**
Malaysia	3m Klibor	3.65	3.65	3.65	**3.65**	3.65	3.65	3.40	**3.40**
	3Y	3.35	3.35	3.35	**3.35**	3.35	3.35	3.20	**3.20**
	10Y	3.75	3.80	3.85	**3.90**	3.95	3.95	3.90	**3.90**
	10Y-3Y	40	45	50	**55**	60	60	70	**70**
Philippines	3m PHP ref rate	5.55	5.55	5.55	**5.55**	5.55	5.55	5.55	**5.55**
	2Y	5.75	5.75	5.75	**5.75**	5.75	5.75	5.75	**5.75**
	10Y	6.00	6.00	6.00	**6.00**	6.00	6.00	6.00	**6.00**
	10Y-2Y	25	25	25	**25**	25	25	25	**25**
Singapore	3m Sibor	1.95	1.95	1.95	**1.95**	1.95	1.95	1.95	**1.95**
	2Y	2.00	2.00	2.00	**2.00**	2.00	2.00	2.00	**2.00**
	10Y	2.15	2.15	2.18	**2.20**	2.20	2.20	2.20	**2.20**
	10Y-2Y	15	15	18	**20**	20	20	20	**20**
Thailand	3m Bibor	1.85	1.85	1.85	**1.85**	1.85	1.85	1.85	**1.85**
	2Y	1.80	1.80	1.80	**1.80**	1.80	1.80	1.80	**1.80**
	10Y	2.40	2.40	2.50	**2.60**	2.60	2.60	2.60	**2.60**
	10Y-2Y	60	60	70	**80**	80	80	80	**80**
China	1 yr Lending rate	4.35	4.35	4.35	**4.35**	4.35	4.35	4.35	**4.35**
	3Y	2.90	2.80	2.80	**2.80**	2.80	2.80	2.80	**2.80**
	10Y	3.20	3.15	3.10	**3.15**	3.20	3.25	3.25	**3.25**
	10Y-3Y	30	35	30	**35**	40	45	45	**45**
Hong Kong	3m Hibor	2.00	2.00	2.00	**2.00**	2.00	2.00	2.00	**2.00**
	2Y	1.70	1.70	1.70	**1.70**	1.70	1.70	1.70	**1.70**
	10Y	1.85	1.85	1.90	**1.95**	2.00	2.00	2.00	**2.00**
	10Y-2Y	15	15	20	**25**	30	30	30	**30**
Korea	3m CD	1.90	1.90	1.90	**1.90**	1.90	1.90	1.90	**1.90**
	3Y	1.80	1.80	1.80	**1.80**	1.80	1.80	1.80	**1.80**
	10Y	2.00	2.00	2.10	**2.10**	2.10	2.10	2.05	**2.05**
	10Y-3Y	20	20	30	**30**	30	30	25	**25**
India	3m Mibor	7.35	7.00	6.90	**6.80**	6.70	6.70	6.70	**6.70**
	2Y	6.80	6.65	6.50	**6.50**	6.50	6.50	6.50	**6.50**
	10Y	7.30	7.40	7.50	**7.50**	7.50	7.50	7.50	**7.50**
	10Y-2Y	50	75	100	**100**	100	100	100	**100**

%, eop, govt bond yield for 2Y and 10Y, spread bps

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