# DBS Monthly

## Searching for a breather

**Economics/Strategy/Rates/FX/Equities/Credit**

Group Research

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- ***Economics****: The global economy is confronting trade wars on multiple fronts, broader China-US power struggle, brewing US-Iran conflict, and a secular slowdown in the electronics cycle. Considering these headwinds, so far there has been remarkably little downside to economic growth, while asset markets have in fact rallied in expectation of policy support. Market participants are keen to find some room to breathe, but recent movement in gold and oil shows that risk aversion may have bottomed and is primed for a spike.*

- ***FX:*** *There is no correct amount of caution going into the Xi-Trump meeting at the Osaka G20 Summit on June 29. For the Chinese yuan, the Xi-Trump meeting is a binary event. Meanwhile, the post-FOMC sell-off in the US dollar has run into a brick wall. At home, the Monetary Authority of Singapore (MAS) has not ruled out an off-cycle easing in its SGD policy.*

- ***Rates****: Positioning across the different asset classes are likely to be light as we await the outcome of the G20 meeting this weekend. By many measures, the rally in developed market govvies looks stretched. In Asia, we think central banks will be emboldened to ease further, especially if the Fed delivers two cuts as we expect.*




Refer to important disclosures at the end of this report.

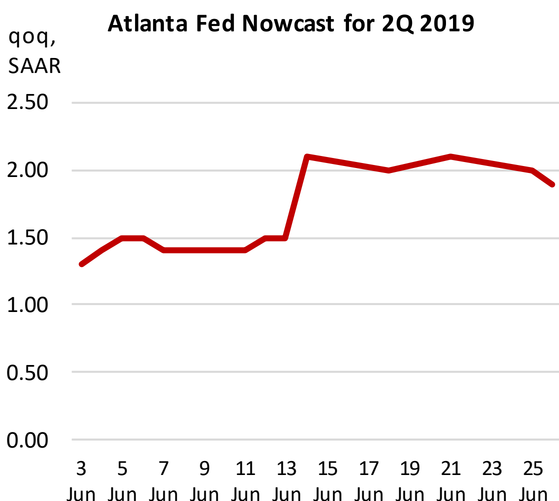
## Searching for a breather

**As the G-20 meetings in Japan begin, there is little chance that the large number of worries on the screen of global investors will shrink anytime soon.** The China-US trade war and a much-needed resumption of bilateral dialogue may well be the matter under scrutiny, unfortunately there is plenty more to warrant concern.

Regardless of the outcome of the China-US trade talks, new fronts on trade war keep opening up. India has faced measures from the US, automakers in Asia and Europe are under threat (also from the US), while Mexico averted tariffs on the pretext of immigrant matters at the very last moment. We don't see the Trump White House finding resolving any of these issues particularly urgent.

Then there is the broader China-US power struggle, ranging from cyber security to the South China Sea. Implicitly related to this is also the North Korea situation. Finally, alarming escalation has taken place with respect to Iran, darkening the outlook of crude oil and LNG supply.

**Considering these headwinds, so far there has been remarkably little downside to economic growth worldwide.** The Federal Reserve may be sounding increasingly dovish, but the economic dataflow hardly warrants a particularly defensive posture, in our view. The Atlanta Fed's GDP Nowcast for the April-June quarter show hardly any concerning trends, with June data available so far show an economy still in good health.

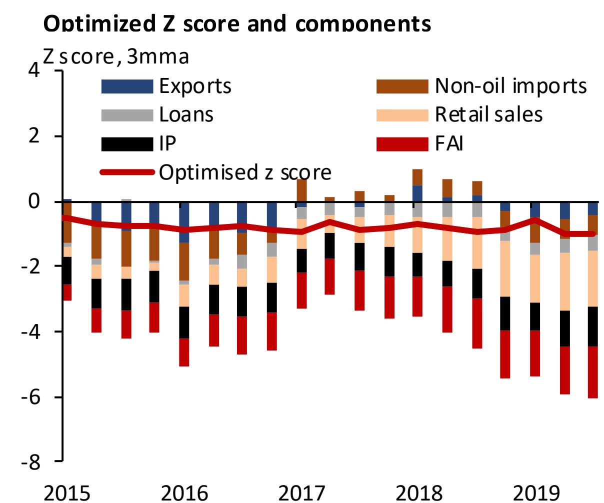



Source: Federal Reserve of Atlanta; DBS

Worldwide, asset markets have in fact rallied in expectation of policy support. Market participants are keen to find some room to breathe, but recent movement in gold and oil shows that risk aversion may have bottomed and is primed for a spike.

China's slowdown has picked up after a supportive 1Q, feeding into the global policy easing narrative. Our Nowcast model sees steady decline in the growth momentum, with growth heading to 6% by 3Q. We think that weak demand out of China is a key reason why global crude oil prices have yet to spike despite the ongoing tensions in the Persian Gulf.

**China's slowing growth narrative**




Source: CEIC, DBS

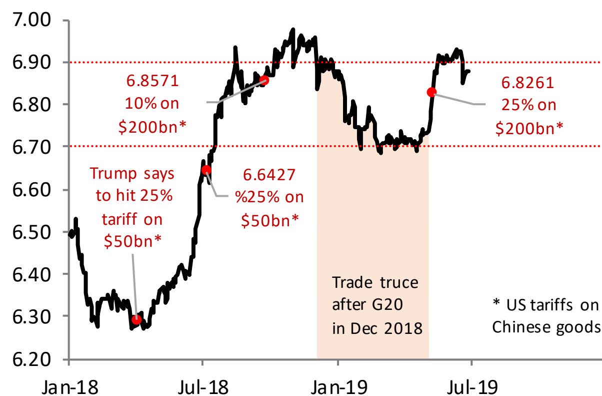
**The challenge for global policy makers is not further easing; they are keen to ease in any case, in our view.** The challenge is to figure out how to do this without running out of easing room quickly, and how to maintain financial stability at a time when debt will likely rise (from an already elevated level) in response to ease monetary policy. Meanwhile, risk assets are rallying, counter-intuitively given the growth concerns. Chances are that the Fed's rate cut cycle this time will be shallow and short-lived. The ECB will find it hard to make negative rates become significantly more negative. China has cut rates considerably already, and short of getting into formal QE, their space is pretty narrow too. Search for breathing space may take investors to strange places.

*Taimur Baig*

## FX: Ending 1H19 on a weaker note

**There is no correct amount of caution going into the Xi-Trump meeting at the Osaka G20 Summit on June 29.** The red lines over tariffs remain a hurdle to a trade deal and the resumption of progressive trade talks between the world's two largest economies. US President Trump has not backed down on whether to impose after the G20 new tariffs of 10% or 25% on the remaining USD325bn of Chinese imports into America. Having been "once bitten, twice shy", China is not keen on another trade truce like the one struck at Bueno Aires G20 last December.

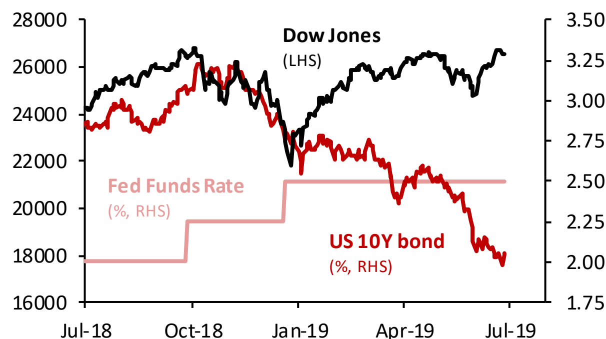
**USDCNY in a 6.70-6.90 "tariff war" range**




Sources: DBS Research, Bloomberg data

**For the Chinese yuan, the Xi-Trump meeting is a binary event.** A further escalation in trade tensions could lead the yuan to depreciate past the pivotal 7 level on prospects for more aggressive monetary/fiscal measures to cuhsion the Chinese economy. A tariff truce could keep USDCNY within the 6.70-6.90 range it has been since the start of te tariff war. The yuan has not been able to appreciate past 6.70 during the trade talks in January-May because US did not agree to China's condition to reverse tariffs for a trade deal.

**In the US, equities are not as bearish as bonds over the outlook for the US economy**

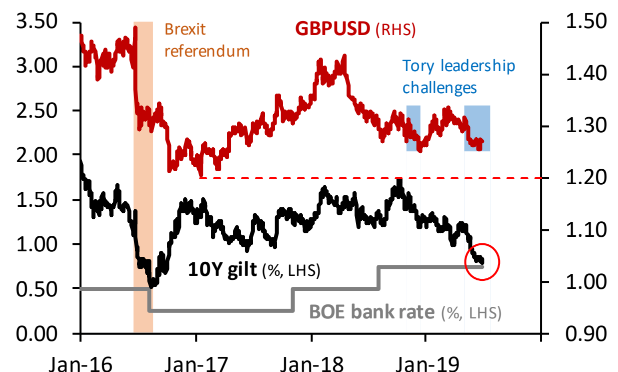



Sources: DBS Research, Bloomberg data

**The post-FOMC sell-off in the US dollar has run into a brick wall.** The Fed has taken issue with the US bond market's aggressive bet for a 50 bps cut in July. St Louis Fed President James Bullard, who called for two cuts this year, affirmed that a 25 bps "insurance cut" would suffice at the next FOMC meeting to cushion the US economy from trade-related growth risks. Bullard's comments should dispel the notion that that insurance cuts do not imply the start of an easing cycle.

**Hard Brexit risks have gotten heavier on the British pound with the Bank of England's dovish tilt.** The BOE has, until this week, been the only major central bank sticking to its rate hike plans, bucking the dovish tones in the Fed and European Central Bank. BOE Governor Mark Carney reminded markets that the bank's baseline forecasts were based on a smooth Brexit, now considered a shaky assumption.

**GBP to revisit post-referendum low on hard Brexit risk**



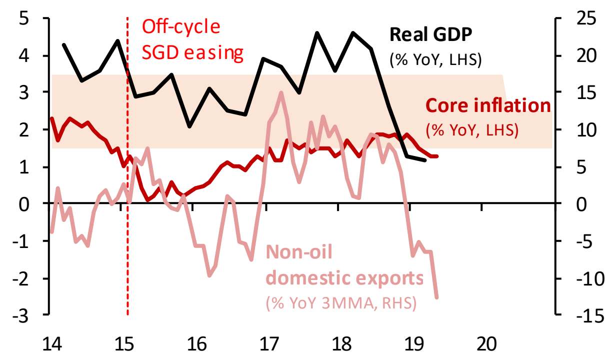

Sources: DBS Research, Bloomberg data

As the frontrunner in the Tory leadership contest, Boris Johnson is expected to succeed Theresa May as British prime minister on July 24. Johnson has been pushing a "Believe in Britain" mantra and predicted a "million-to-one" chance of the UK exiting the EU without a deal on October 31. Hence, Carney signaled that the BOE would probably cut rates in the event of a no-deal Brexit. Hence, pay close attention to the 10Y gilt. The pound will test its 1.25 low again when the bond yield falls below the BOE bank rate currently at 0.75%.

**The Monetary Authority of Singapore (MAS) has not ruled out an off-cycle easing in its SGD policy**. The last time the SGD NEER policy was eased outside the usual semi-annual policy reviews in April or October was January 2015. Back then, growth in key indicators such as GDP and non-oil domestic exports were stronger. The

government is reviewing its 2019 growth forecast which was revised down only a month ago (on May 20) to 1.5-2.5% from 1.5-3.5% previously. The fallout from renewed global trade tensions was evident in weak non-oil domestic exports; the -12.7% YoY (3-month moving average) contraction was worse than the -9.6% floor in 2016. Pay close attention to core inflation which has slowed steadily from 1.7% YoY in January to 1.3% in May, into the lower half of its official 1-2% forecast range.

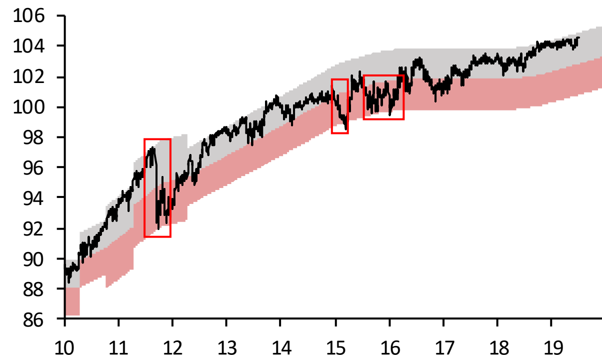
**Singapore's key indicators are weak enough to consider an off-cycle easing in the SGD NEER policy**




Sources: DBS Research, Bloomberg data

**Given increased prospects for a policy easing this year, the SGD NEER is considered too strong** in the highest quartile of its policy band. The SGD NEER was in the lower half of its policy band during the off-policy meeting in January 2015. According to our model, the lower half of the SGD NEER band is located, in USDSGD terms, between 1.3760 and 1.4040 this morning.

**SGD NEER has been in the lower half of its policy band during past easings**




Sources: DBS Research, Bloomberg data

**DBS SGD policy band in USDSGD terms** as of June 28, 0830h

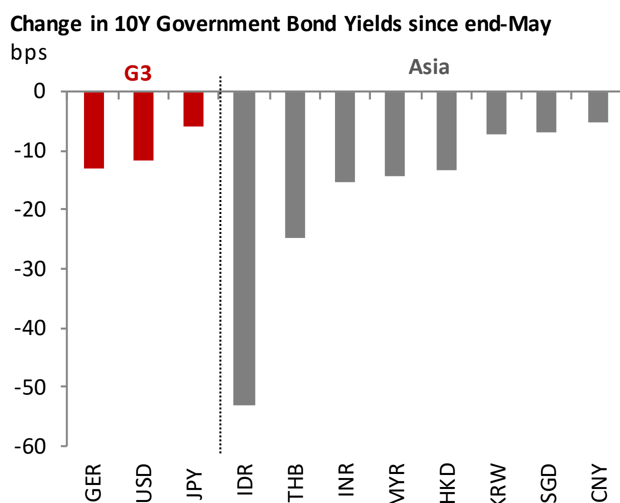
| Estimates | Lower Limit | Mid-point | Upper Limit |
|---|---|---|---|
| USDSGD | 1.3490 | 1.3760 | 1.4040 |

*Philip Wee*

## Rates: Lower for longer

**Positioning across the different asset classes are likely to be light as we await the outcome of the G20 meeting this weekend.** Expectations of a deal have been building with the market exhibiting USD weakness and stock markets generally buoyant. In the rates space, this has been reflected with 10Y UST and German yields bouncing back above 2% and -0.3% respectively. Clearly this is a binary event and we think that the base case would be for a trade truce to take place. If so, some of the rally in DM govvies is likely to be unwound. On the upside, immediate resistance to 10Y US yields is around 2.15%. Clearly, a trade deal would remove some of the urgency from the Fed and the European Central Bank (ECB) to ease policy. **However, with economic data across the globe looking lackluster, policy easing still looks far more likely than not in the US.**

**Change in 10Y Government Bond Yields since end-May**




Source: Bloomberg

**By many measures, the rally in developed market govvies looks stretched**. 10Y UST yields are already more than 120bps down its peak last year. Similarly, 10Y German yields pushed to a fresh low (below -0.3%), reinforcing the fact that zero is not the floor for rates. We think that there is a need to differentiate between insurance cuts (2-3 cuts) and recession cuts (4 or more). Unfortunately, quite a bit hinges on the G20 outcome and at this point, it is probably too early to say that US data decisively point towards an upcoming recession. A slowdown is probably inevitable and should lead to USD rates persistently pricing in Fed cuts even if a favorable trade talk outcome occurs during the G20 meeting.

**The ECB's was more dovish than anticipated.** With the deposit rate already at -0.4% and a scarcity of selected government papers (notably Germany) from previous rounds of asset purchases, we thought that the ECB might be more reticent. Such concerns appear unfounded as Draghi signalled that rate cuts and QE are on the cards, driving the rates space to factor in 13bps of cuts by the end of the year. If QE is announced, we suspect that it would be the peripheral govvies that benefit the most as the ECB would probably have to loosen the criteria and reduce weightage on economies that have limited outstanding papers.

**Meanwhile, the Bank of Japan (BOJ) appears to be the least dovish of the G3 central banks.** That said, Kuroda did indicate that the yield curve band (±20bps) should be interpreted more loosely. With the 10Y yield target at zero, the theoretical floor is -0.2%. This suggests that the BOJ may not enforce the floor and allow 10Y yields (last at -0.18%) to drift even lower. Room to hold off easing may be constrained if the yen becomes too strong and perhaps explains why JPY interest rates have drifted lower despite a more "neutral" BOJ.

**In Asia, we think central banks will be emboldened to ease further,** especially if the Fed delivers two cuts as we expect. India followed through on easing with a 25bps cut in Jun. Bank Indonesia (BI) took a tentative step towards easing by reducing the reserve requirement ratio while Bangko Sentral ng Pilipinas (BSP) held rates. We think that further cuts from these central banks are likely. **In any case, the government bond market (Indonesia and the Philippines) held up well despite no rate cuts this month**. 10Y Indo govvie yields are down by more 50bps since the start of the month. Similarly, 10Y Philippines yields were down by over 40bps over the same period. There are downside risks to our rates forecasts across several markets including Thailand, Malaysia, Korea and the Philippines.

*Eugene Leow*

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## Growth, Inflation, Policy Rates & FX forecasts

| | GDP growth, % YoY | | | | CPI inflation, % YoY, ave | | | |
|---|---|---|---|---|---|---|---|---|
| | 2017 | 2018 | 2019f | 2020f | 2017 | 2018 | 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* | 8.2 | 7.2 | 6.8 | 6.8 | 4.5 | 3.6 | 3.4 | 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 | 0.9 | 1.6 |
| Philippines** | 6.7 | 6.2 | 6.1 | 6.1 | 2.9 | 5.2 | 3.1 | 3.1 |
| Singapore | 3.9 | 3.2 | 2.1 | 2.5 | 0.6 | 0.4 | 1.1 | 1.5 |
| South Korea | 3.1 | 2.7 | 2.1 | 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 | 3.4 | 3.5 | 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 | 1.7 | 1.6 |

* 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 | 5.75 | 5.50 | 5.25 | 5.25 | 5.25 | 5.25 | 5.25 |
| Indonesia | 6.00 | 6.00 | 6.00 | 6.00 | 6.00 | 6.00 | 6.00 | 6.00 |
| Malaysia | 3.25 | 3.00 | 3.00 | 2.75 | 2.75 | 2.75 | 2.75 | 2.75 |
| Philippines | 4.75 | 4.50 | 4.25 | 4.25 | 4.25 | 4.25 | 4.25 | 4.25 |
| Singapore** | 1.95 | 1.95 | 1.95 | 1.95 | 1.95 | 1.95 | 1.95 | 1.95 |
| South Korea | 1.75 | 1.75 | 1.50 | 1.50 | 1.50 | 1.50 | 1.50 | 1.50 |
| 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 | 2.25 | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 |

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

### Exchange rates, eop

| | Mar 29 | Q2 19 | Q3 19 | Q4 19 | Q1 20 | Q2 20 | Q3 20 | Q4 20 |
|---|---|---|---|---|---|---|---|---|
| USD/CNY | 6.71 | 6.85 | 7.00 | 6.95 | 6.90 | 6.85 | 6.80 | 6.75 |
| USD/HKD | 7.85 | 7.85 | 7.85 | 7.84 | 7.83 | 7.82 | 7.81 | 7.80 |
| USD/INR | 69.2 | 70.0 | 71.0 | 71.5 | 71.0 | 70.5 | 70.0 | 69.5 |
| USD/IDR | 14243 | 14300 | 14500 | 14400 | 14300 | 14200 | 14100 | 14000 |
| USD/MYR | 4.08 | 4.20 | 4.25 | 4.23 | 4.21 | 4.19 | 4.17 | 4.15 |
| USD/PHP | 52.6 | 53.0 | 55.0 | 54.5 | 54.0 | 53.5 | 53.0 | 52.5 |
| USD/SGD | 1.36 | 1.37 | 1.40 | 1.39 | 1.38 | 1.37 | 1.36 | 1.35 |
| USD/KRW | 1135 | 1170 | 1180 | 1170 | 1165 | 1160 | 1155 | 1150 |
| USD/THB | 31.7 | 32.0 | 33.0 | 32.8 | 32.6 | 32.4 | 32.2 | 32.0 |
| USD/VND | 23189 | 23400 | 23500 | 23450 | 23400 | 23350 | 23300 | 23250 |
| AUD/USD | 0.71 | 0.68 | 0.64 | 0.66 | 0.68 | 0.70 | 0.72 | 0.74 |
| EUR/USD | 1.12 | 1.10 | 1.08 | 1.09 | 1.10 | 1.11 | 1.12 | 1.13 |
| USD/JPY | 111 | 110 | 112 | 111 | 110 | 109 | 108 | 107 |
| GBP/USD | 1.30 | 1.26 | 1.22 | 1.24 | 1.26 | 1.28 | 1.30 | 1.32 |

Australia, Eurozone and United Kingdom are direct quotes

## Rates forecasts

| | | 2019 | | | | 2020 | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Q1 | Q2 | Q3 | **Q4** | Q1 | Q2 | Q3 | **Q4** |
| US | 3m Libor | 2.60 | 2.60 | 2.35 | **2.10** | 2.10 | 2.10 | 2.10 | **2.10** |
| | 2Y | 2.26 | 2.00 | 2.00 | **2.10** | 2.20 | 2.20 | 2.20 | **2.20** |
| | 10Y | 2.41 | 2.05 | 2.10 | **2.20** | 2.30 | 2.40 | 2.50 | **2.50** |
| | 10Y-2Y | 15 | 5 | 10 | **10** | 10 | 20 | 30 | **30** |
| Japan | 3m Tibor | 0.07 | 0.05 | 0.05 | **0.05** | 0.05 | 0.05 | 0.05 | **0.05** |
| | 2Y | -0.17 | -0.20 | -0.17 | **-0.15** | -0.15 | -0.15 | -0.13 | **-0.10** |
| | 10Y | -0.08 | -0.15 | -0.10 | **-0.10** | -0.05 | -0.05 | 0.00 | **0.00** |
| | 10Y-2Y | 9 | 5 | 7 | **5** | 10 | 10 | 13 | **10** |
| Eurozone | 3m Euribor | -0.31 | -0.30 | -0.30 | **-0.30** | -0.30 | -0.30 | -0.30 | **-0.30** |
| | 2Y | -0.60 | -0.65 | -0.60 | **-0.55** | -0.55 | -0.55 | -0.50 | **-0.50** |
| | 10Y | -0.07 | -0.30 | -0.25 | **-0.20** | -0.15 | -0.10 | -0.05 | **-0.05** |
| | 10Y-2Y | 53 | 35 | 35 | **35** | 40 | 45 | 45 | **45** |
| Indonesia | 3m Jibor | 7.21 | 7.20 | 7.20 | **7.20** | 7.20 | 7.20 | 7.20 | **7.20** |
| | 2Y | 6.78 | 6.90 | 6.80 | **6.70** | 6.70 | 6.70 | 6.70 | **6.70** |
| | 10Y | 7.63 | 7.70 | 7.60 | **7.50** | 7.50 | 7.50 | 7.50 | **7.50** |
| | 10Y-2Y | 86 | 80 | 80 | **80** | 80 | 80 | 80 | **80** |
| Malaysia | 3m Klibor | 3.69 | 3.44 | 3.44 | **3.19** | 3.19 | 3.19 | 3.19 | **3.19** |
| | 3Y | 3.38 | 3.40 | 3.40 | **3.40** | 3.40 | 3.40 | 3.40 | **3.40** |
| | 10Y | 3.77 | 3.85 | 3.90 | **3.95** | 4.00 | 4.00 | 4.10 | **4.10** |
| | 10Y-3Y | 39 | 45 | 50 | **55** | 60 | 60 | 70 | **70** |
| Philippines | 3m PHP ref rate | 5.55 | 5.30 | 5.05 | **5.05** | 5.05 | 5.05 | 5.05 | **5.05** |
| | 2Y | 5.82 | 5.75 | 5.75 | **5.75** | 5.75 | 5.75 | 5.75 | **5.75** |
| | 10Y | 5.61 | 6.00 | 6.00 | **6.00** | 6.00 | 6.00 | 6.00 | **6.00** |
| | 10Y-2Y | -21 | 25 | 25 | **25** | 25 | 25 | 25 | **25** |
| Singapore | 3m Sibor | 1.94 | 1.95 | 1.80 | **1.60** | 1.60 | 1.60 | 1.60 | **1.60** |
| | 2Y | 1.92 | 1.85 | 1.75 | **1.80** | 1.90 | 1.90 | 1.90 | **1.90** |
| | 10Y | 2.07 | 2.00 | 1.95 | **2.00** | 2.05 | 2.15 | 2.25 | **2.25** |
| | 10Y-2Y | 15 | 15 | 20 | **20** | 15 | 25 | 35 | **35** |
| Thailand | 3m Bibor | 1.88 | 1.85 | 1.85 | **1.85** | 1.85 | 1.85 | 1.85 | **1.85** |
| | 2Y | 1.78 | 1.80 | 1.80 | **1.80** | 1.80 | 1.80 | 1.80 | **1.80** |
| | 10Y | 2.43 | 2.40 | 2.50 | **2.60** | 2.60 | 2.60 | 2.60 | **2.60** |
| | 10Y-2Y | 65 | 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 | 2.91 | 2.80 | 2.80 | **2.80** | 2.80 | 2.80 | 2.80 | **2.80** |
| | 10Y | 3.36 | 3.15 | 3.10 | **3.15** | 3.20 | 3.25 | 3.25 | **3.25** |
| | 10Y-3Y | 45 | 35 | 30 | **35** | 40 | 45 | 45 | **45** |
| Hong Kong | 3m Hibor | 1.76 | 2.10 | 1.95 | **1.80** | 1.80 | 1.80 | 1.80 | **1.80** |
| | 2Y | 1.45 | 1.80 | 1.70 | **1.75** | 1.80 | 1.80 | 1.80 | **1.80** |
| | 10Y | 1.47 | 1.65 | 1.75 | **1.90** | 2.00 | 2.10 | 2.20 | **2.20** |
| | 10Y-2Y | 2 | -15 | 5 | **15** | 20 | 30 | 40 | **40** |
| Korea | 3m CD | 1.90 | 1.90 | 1.76 | **1.76** | 1.76 | 1.76 | 1.76 | **1.76** |
| | 3Y | 1.69 | 1.75 | 1.75 | **1.75** | 1.75 | 1.75 | 1.75 | **1.75** |
| | 10Y | 1.83 | 1.95 | 2.05 | **2.05** | 2.05 | 2.05 | 2.00 | **2.00** |
| | 10Y-3Y | 14 | 20 | 30 | **30** | 30 | 30 | 25 | **25** |
| India | 3m Mibor | 7.42 | 6.75 | 6.40 | **6.05** | 6.05 | 6.05 | 6.05 | **6.05** |
| | 2Y | 6.88 | 6.10 | 6.00 | **6.10** | 6.20 | 6.30 | 6.30 | **6.30** |
| | 10Y | 7.22 | 6.60 | 6.60 | **6.85** | 7.00 | 7.10 | 7.20 | **7.20** |
| | 10Y-2Y | 34 | 50 | 60 | **75** | 80 | 80 | 90 | **90** |

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

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**Sources**: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations)

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