Economics

Chart of the Week: Why Libor has not moved despite Fed rate hikes

Group Research

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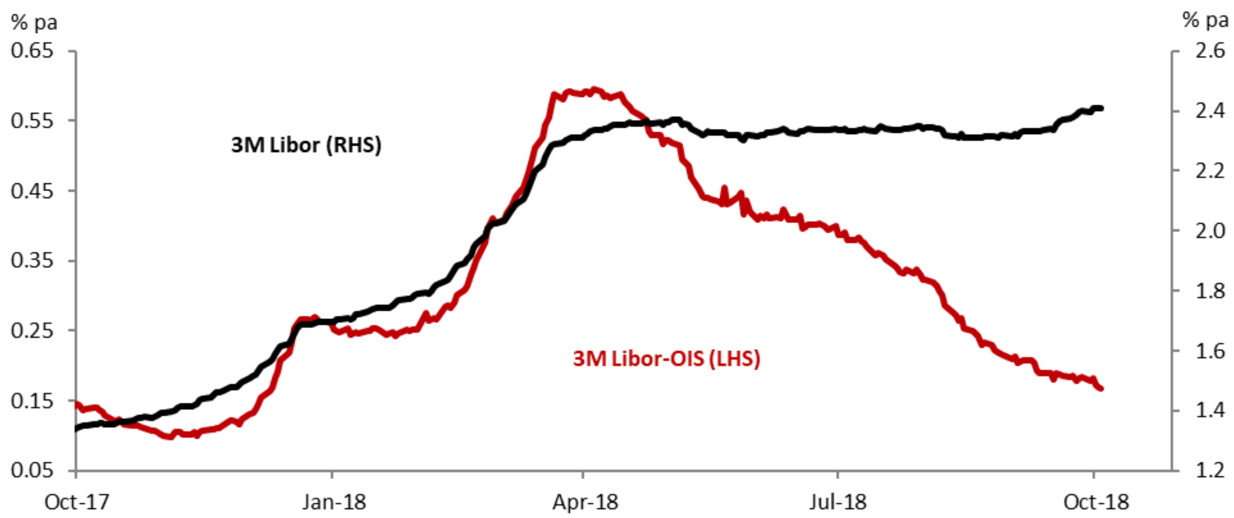
Key Events:

- *Singapore's 3Q GDP growth (advance) could had fallen to 2.1% YoY, largely due to the high base last year.*
- *China's September exports growth likely slowed to 7.8% YoY as front-loading activities of prior months wear off.*
- *India's September CPI is expected to stay below the 4% target for a second consecutive month.*

Chart of the Week: Factors driving the stable Libor could unwind soon

Although the US Federal Reserve has hiked its target rate a combined 50bps in June and September, the 3M Libor (2.40%) has been largely unchanged since April. Why? First, net issuances of Treasury Bills and Commercial Paper (CP) accelerated in the December - March period, pushing 3M Libor higher. Second, repatriation flows saw an initial surge in 1Q, decreasing sharply the supply of US dollars overseas. Both trends then began to taper off in April, driving the retracement (US companies repatriated an estimated USD170bn in 2Q vs USD295bn in 1Q). Looking ahead, the 3M Libor-OIS spread could be due to rebound. A widening US budget gap means T-Bill issuances are likely to be ramped-up in 4Q. We could also begin to see some spillover to 3M Libor from FX swap markets (where 3M US dollar funding has tightened considerably in the past week).

Tightening of spread (to OIS) has allowed 3M Libor to stay unchanged despite 50bps of Fed hikes.



Source: Bloomberg, DBS

Event	Consensus	DBS	Previous
Oct 8 (Mon)			
Taiwan: trade balance (Sep)		USD5.03bn	USD4.53bn
- exports		0% y/y	1.9% y/y
- imports		7.4% y/y	7.9% y/y
Oct 11 (Thu)			
Malaysia: industrial production (Aug)	2.5% y/y	2.2% y/y	2.6% y/y
US: CPI (Sep)	2.4% y/y	2.5% y/y	2.7% y/y
Oct 12 (Fri)			
Singapore: GDP (3Q; A)	2.6% y/y	2.1% y/y	3.9% y/y
--	5.5% q/q saar	3.4% q/q saar	0.6% q/q saar
Singapore: MAS monetary policy meeting		0.5% increase in slope of SGD NEER band	
India: CPI (Sep)		3.8% y/y	3.69% y/y
India: industrial production (Aug)		5.2% y/y	6.6% y/y
China: trade balance (Sep)	USD24.55bn	USD19.8bn	USD27.89bn
- exports	8.7% y/y	7.8% y/y	9.8% y/y
- imports	14.5% y/y	17.0% y/y	19.9% y/y

China: After the front-loading activities before the second round of tariffs, exports growth should have slowed to 7.8% in September, down from 9.8% YoY in the previous month. Import growth is also expected to ease back, at 17.0% YoY, despite appreciable increase in oil prices. This is largely due to the weakened domestic demand (retail sales growth stayed low at 9.3% YoY in August). In fact, early indicators already point to moderating trade sentiments. New export orders PMI and imports PMI are in contractionary zone for 4 and 3 consecutive months respectively. Trading balance is set to deteriorate in the months ahead

India: September CPI inflation, due on Friday, is likely to stay below the 4% target for a second consecutive month. Inflation likely rose to 3.8% YoY, from 3.7% month before, as lower food costs negate the pass-through of higher fuel and transport components. Pulses and commonly-used vegetables slipped on month-on-month terms. Sub-inflation reaffirms the central bank’s decision to keep rates on hold last week, prioritising their inflation mandate, rather than getting fixating with the currency direction. Industrial production growth likely eased to 5.2% YoY vs 6.6% in July, inferring from a moderation in core industries index and a pullback in manufacturing PMI index. Higher input prices are increasingly being reflected in PMI and wholesale price indices, as manufacturers are expected to pass-on part of the costs to preserve margins.

Malaysia: Industrial output for August is due this week and production growth is expected to ease marginally to 2.2% YoY, from 2.6% previously. However, there could be downside risk to that noting the sharp drop in export growth from +9.4% in July to a decline of 0.3%. That said, weakness in industrial production is expected to be more moderate. Besides price effects from the depreciation of the MYR, there has been frontloading of orders by some US and China companies ahead of the tariff hikes in July. Such phenomenon probably sparked off a chain reaction in the regional supply chain, resulting in the surge in the previous months’ figures, followed by a fall in August. The outlook in the coming months could be less drastic, as companies adjust to the new trade environment gradually.

Singapore: Advance GDP growth for the third quarter will see a sharp drop to 2.1% YoY, from 3.9% previously. While this could be flagged out as a concern, it’s largely due to the high base in the same period last year. On the margin, growth momentum is expected to improve to 3.4% QoQ saar, from a mere 0.6% previously.

Unlike the earlier concern regarding the impact of the trade war, the manufacturing sector has remained fairly resilient. Expectation is for the sector to clock about 4% expansion. Though the pace of growth is likely to have moderated, it is nowhere near to dipping into contraction, particularly if we consider the arithmetic drag from the high base last year. However, the worry is on the services sector. Risk aversion from the trade war and higher interest rates have sent financial markets into tailspin. Property market measures from the government probably would have also cooled activity in the business service sector as well. Expect further moderation in the overall services sector to about 2% in the quarter, from 2.8% previously.

While the trade tensions between Singapore's two largest export market, the US and China, could indirectly affect Singapore in the near term, it could also bring about opportunities in the longer term. But in the immediate term, tighter liquidity conditions and mounting pressure on regional currencies have affected inventor's confidence and business sentiments. Expectation is for third quarter's growth to be the weakest this year. Our below consensus forecast of 3.0% for 2018 GDP growth remains on track, albeit with a modest upside risk given the resilience in the manufacturing sector.

We expect the Monetary Authority of Singapore (MAS) to increase again, the slope of the SGD nominal effective exchange rate (NEER) policy band by another 0.5% to 1% per year. For now, the Singapore economy is expected to expand within its official 2.5-3.5% forecast range, not only in 2018 but also in 2019. The MAS core inflation is near the top of its 1-2% forecast range with CPI inflation set to move into a higher 1-2% forecast range in 2019 from 0-1% this year. Like many major central banks, the MAS is concerned about the global risks (especially a prolonged trade war) to the world economy but they are not enough to hold back policy normalization. As witnessed in the past six months, Singapore's fundamentals (e.g. current account surpluses of 19% of GDP) have been sufficient to keep the SGD NEER firm even whilst the SGD depreciates against the strong USD. Looking ahead, we continue to see the value of the USD rising above SGD1.40 later this year.

Taiwan: Export growth is expected to have fallen to about 0% YoY in September, due to the fewer number of working days caused by the Mid-Autumn Festival. Excluding the calendar effect, export demand should also be softening, due to the slowdown in the Chinese economy and moderation in the electronics cycle. Imports, on the other hand, would have maintained a steady growth of 7%, mainly due to the rise in global oil prices. Capital goods imports may have weakened as the business sector postpones investment plans amidst the trade war concerns.

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