Economics & Strategy Weekly

Peak Dollar? Not quite

DBS Group Research

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Taimur Baig
Chief Economist
taimurbaig@dbs.com

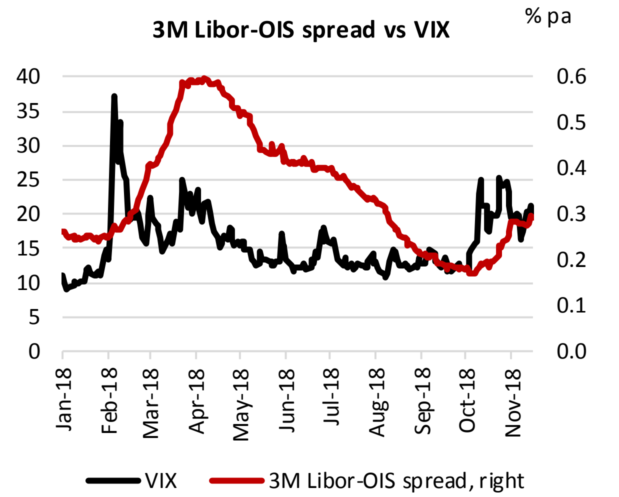
Samuel Tse
Economist
samueltse@dbs.com

Please direct distribution queries to
Violet Lee +65 68785281 violetleeyh@dbs.com

- *Sharp selloff in oil markets has eased pressure on EM currencies characterised by large external funding needs, but this is likely to be a temporary respite*
- *Expectations of peak growth, peak earnings, and peak fiscal support may begin to push back against USD strength*
- *But with Fed rate hikes and quantitative tightening likely to continue, it is too early to call peak dollar*
- *Global transaction data show a sharp decline in USD usage in recent years, but examining a long time series reveals that there is not much to read from the trend*
- *Despite valiant attempts, China has not managed to make the CNY a widely used currency yet, as per SWIFT data*

Vols return, but EM also gets a breather

Since the beginning of October, there has been a spike in asset market volatility, first such occurrence since February. Along with equities and rates (See chart below), volatility has been considerable in the oil market.



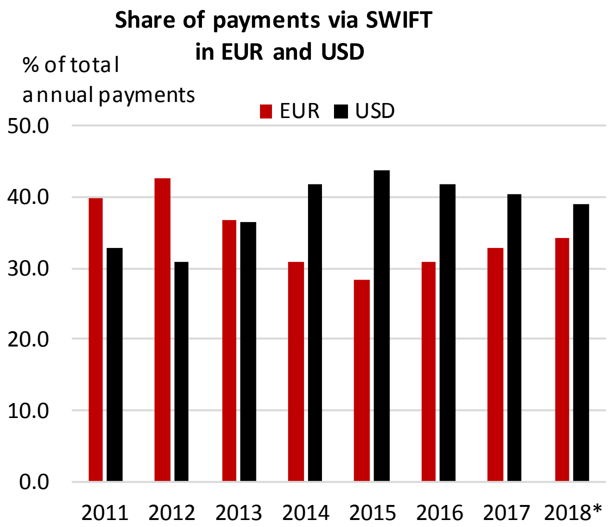
Source: Bloomberg, DBS

Thanks to repeated upside surprise in US oil production data and some waivers with respect to US sanctions on Iran, oil prices have corrected by 25% since the beginning of October. This has helped EM currencies characterised by large external funding needs, with the IDR and INR appreciating by 2% and 0.6% against the USD so far this month. Note however that despite this sharp decline, oil prices are still up about 2%yoy, and about 25% higher than where they were in 2016. The ongoing correction, therefore, won't warrant a major change in the annual projections of current account deficits of the likes on India and Indonesia, in our view.

Peak USD? Not quite

We see the market beginning to push back at the USD strength narrative by beginning to price in peak growth, peak earnings, and peak fiscal support in the US. We however think that the Fed is far from relenting. While US GDP Nowcast shows growth no longer tracking 3%+ and inflation markers are still muted, as long as growth is well above 2% and wages are picking up, the Fed will continue to hike, in our view. As dollar liquidity continues to tighten, and the political economic dynamics in China, Europe, and the UK remain challenging, the USD will likely remain supported.

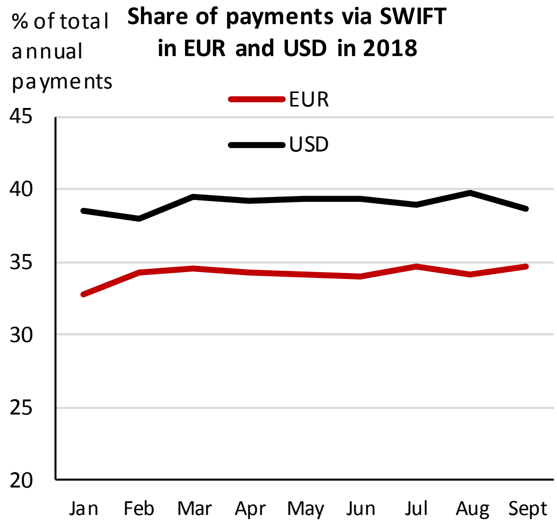
But beyond the immediate outlook, is there a trend that suggests that USD usage is peaking? After all, ongoing trade wars, selective sanctions, and an overall hyper-assertiveness of US foreign policy ought to be pushing the likes of China and Russia, and perhaps even the Eurozone, to reduce their dependence on the dollar. We use data from SWIFT, a key provider of financial transaction services worldwide, used by 11000 financial institutions in 200+ countries, to examine this issue (see chart below).



Source: Bloomberg, DBS

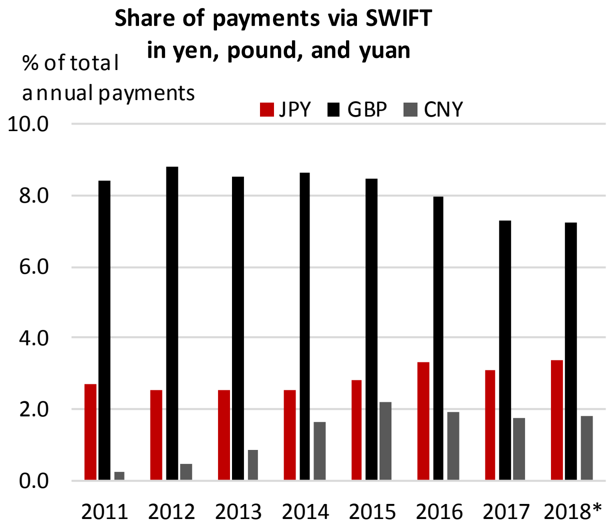
At first glance, it appears that there has indeed been a move toward using the USD less (and EUR more), with a sizeable switch between USD and EUR usage since 2015 (-11% and +20%). But when one looks at a longer time horizon, this does not come across as dramatic, rather somewhat of a reflection of mean reversion. There was a sharp decline in euro usage during the EU sovereign debt crisis, but that bottomed after the ECB launched QE in March 2015. As for USD usage, it fell during last year's reflation trade, but has stabilised this year. Indeed, compared to the beginning of this decade, USD and EUR usages as a share of total transaction messages transmitted through SWIFT look broadly the same.

Looking at the same data on monthly frequency for 2018, the picture looks particularly stable. Despite gyration in exchange rates, trade wars, Fed hikes, quantitative tightening, and a very noisy White House, share of payments via SWIFT in USD has been flat through the course of this year.



Source: Bloomberg, DBS

What about the Chinese yuan? China's share of global trade is considerable, the country has made a major push toward internationalising its currency through SDR inclusion and numerous bilateral swap arrangements in recent years. Yet, SWIFT data show less than 2% of payments going through its system to be denominated in CNY, much lower than even GBP and JPY. The road ahead for the CNY to become widely used looks very long.



Source: Bloomberg, DBS

Taimur Baig and Philip Wee

Strategy

FX: In East vs West, Asia comes out on top of Europe

Recent economic and political developments have set the stage for **Asian currencies to extend their appreciation against their weaker European counterparts.**

The pound is at risk of capitulating after Thursday's resignation of three UK ministers over the draft Brexit withdrawal agreement that Prime Minister Theresa May negotiated with the European Union. While the narrative for a leadership challenge has stepped up, UK's plunge into political chaos goes beyond May's job. Over the past half year, May has demonstrated no desire to step down voluntarily and have pre-empted attempts that sought her involuntary removal. Except that this time, May (and her potential successor, if any) risks losing the support of the Democratic Unionist Party (DUP) that provides her government its majority in parliament. Apart from Northern Ireland, Scotland has also thrown its hat into the ring that the Brexit deal was unacceptable. It was only a month ago that former prime minister John Majors warned that Brexit was "a colossal misjudgement that will diminish" the UK. **For the pound, Brexit is no longer simply about a deal or no deal but evolving into an existential crisis regarding the kingdom's unity.**

In Europe, the disappointing growth story weighing on the euro just got heavier. Eurozone's preliminary sub-2% growth for 3Q18 is likely to be downgraded after Germany reported its first quarterly decline since 1Q15. Italy's economy reported zero growth which will steel Rome's resolve to defend its expansionary fiscal spending plans against pressure from Brussels to return Italy to its previous commitment to rein in its budget deficit.

Conversely, the resilience in Asian currencies is best reflected by their weakest members. The Indonesian rupiah and the Philippine peso have appreciated on their rate hikes on November 15. Amidst slower growth and lower oil prices, investors have started to give the peso the doubt that the five hikes totalling 175 bps since May could anchor inflation expectations. The Indian rupee was the clear beneficiary of the 20-25% decline in crude oil prices in the past six weeks. Given the circumstances, markets appear inclined to give Trump-Xi the benefit of the doubt for now to (no matter how unlikely) strike a truce on trade at the G20 Summit a fortnight from today.

Philip Wee

Rates: Two hikes and a hold in Asia

This week, Bank Indonesia (BI) and Bangko Sentral ng Pilipinas (BSP) hiked rates by 25bps while the Bank of Thailand (BoT) kept rates on hold (voting patterns suggest that a hike is imminent). The decision by BI was a surprise. Consensus (and DBS) were firmly in the hold camp. With multiple hikes already delivered for the year and the rupiah showing signs of stabilisation, we thought that the next hike would only come in December (broadly tracking the Fed). Now that this hike has been brought forward, we think that another two hikes can be delivered in 1H19.

For BSP and BoT, consensus was mixed. To be sure, **policy settings in the Philippines are still too accommodative** given where headline CPI (6.7% YoY) is and the rate hike is justified. However, given the BSP's focus on growth (and that inflation is peaking) and relatively dovish slant, a fifth consecutive hike suggests that the governor is more hawkish than previously thought. We think that another 75bps of hikes would take place by mid-2019.

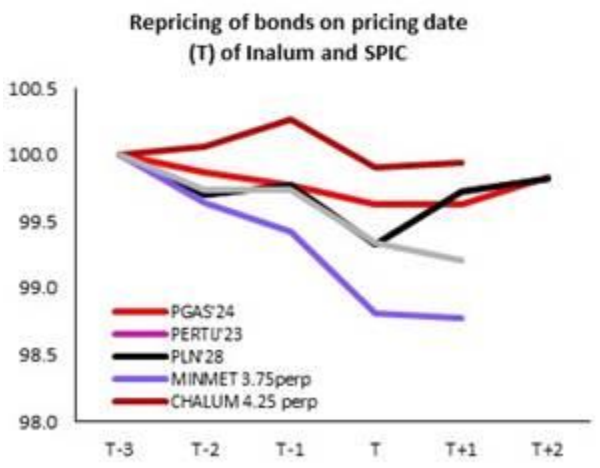
Thailand is not facing overheating risks and firm external account balances have resulted in a resilient THB despite multiple bouts of market volatility this year. Worries about a prolonged period of low rates and widening USD-THB rate differentials are the more likely motivations behind the desire to raise rates. We think **BoT policy normalisation is imminent, but it will likely be a very shallow cycle.**

The upshot is that **financial conditions in Asia (and across EMs) are tightening in line with the US**. The rate increases in the current account deficit economies have been significant but on balance, these adjustments are orderly. **As the Fed takes monetary policy into restrictive territory, we would reasonably expect EM central banks to be dragged along.**

Eugene Leow

Credit: New issues priced to clear

Recent new issues in Asian credit have come with generous new issue premium, reflecting weak market sentiment. While this has been an issue with the Chinese HY space for several months now, recent deals from the high grade space (including quasi-sovereigns) have followed the trend. For example, the USD750mn REC bond issue in end October, USD4bn Inalum deal last week and the relatively smaller USD500mn Chinese State Power Investment Corp (SPIC) this week all came well wide of secondary. While the deals led to repricing of secondary issues in the respective sectors, on a positive note they have performed well subsequently in secondary (e.g. Inalum up between 2 and 5 points across the curve), which also led to some recovery in the related bonds in the respective sectors.



Prices rebased to 100 on T-3;
Sources: Bloomberg, DBS

Weak technical factors in the new issue market will remain a drag on credit market performance for now. This will likely be a more significant issue for the Chinese HY sector in 2019, when around USD30bn of bonds come up for maturity.

Neel Gopalakrishnan

Highlights of the week:

Understanding China: Greater Bay Area: A Capital/Labour/Tech Mega-hub
China chart book - Slowing growth and weakening sentiments
India: Soft CPI gives RBI room to pause
Indonesia: Worsening current account still manageable
Thailand: BOT signals hike is near

Key Forecasts

	GDP growth, % YoY				CPI inflation, % YoY, ave			
	2016	2017	2018f	2019f	2016	2017	2018f	2019f
China	6.7	6.9	6.6	6.2	2.0	1.6	2.1	2.2
Hong Kong	2.0	3.8	3.3	2.9	2.4	1.7	2.0	2.5
India*	8.0	7.1	6.7	7.4	4.9	4.5	3.6	4.4
Indonesia	5.0	5.1	5.1	5.3	3.5	3.8	3.2	4.0
Malaysia	4.2	5.9	4.7	4.5	2.1	3.9	1.3	2.5
Philippines**	6.9	6.7	6.3	6.5	1.3	2.9	5.3	4.7
Singapore	2.0	3.6	3.4	3.0	-0.5	0.6	0.7	1.8
South Korea	2.9	3.1	2.9	2.9	1.0	1.9	1.5	1.8
Taiwan	1.4	2.9	2.7	2.2	1.4	0.6	1.3	1.0
Thailand	3.2	3.9	4.5	4.2	0.2	0.7	1.3	1.6
Vietnam	6.2	6.8	6.4	6.6	2.7	3.5	3.6	3.8
Eurozone	1.8	2.5	1.9	1.8	0.2	1.5	1.4	1.4
Japan	0.9	1.7	1.1	0.9	-0.1	0.5	0.8	1.0
United States***	1.5	2.3	3.0	2.5	1.3	2.1	2.5	2.0

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

	Policy interest rates, eop							
	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	3Q19	4Q19
China*	4.35	4.35	4.35	4.35	4.35	4.35	4.35	4.35
India	6.00	6.25	6.50	6.50	6.75	6.75	7.00	7.25
Indonesia	4.25	4.75	5.75	6.00	6.25	6.50	6.50	6.50
Malaysia	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25
Philippines	3.00	3.50	4.50	4.75	5.00	5.25	5.25	5.25
Singapore**	1.45	1.52	1.64	1.85	2.10	2.30	2.55	2.70
South Korea	1.50	1.50	1.50	1.50	1.50	1.75	1.75	2.00
Taiwan	1.38	1.38	1.38	1.38	1.38	1.38	1.38	1.50
Thailand	1.50	1.50	1.50	1.50	1.75	2.00	2.00	2.00
Vietnam***	6.25	6.25	6.25	6.25	6.50	6.50	6.75	6.75
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	1.75	2.00	2.25	2.50	2.75	3.00	3.25	3.50

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

	Exchange rates, eop							
	Q1 18	Q2 18	Q3 18	Q4 18	Q1 19	Q2 19	Q3 19	Q4 19
China	6.28	6.62	6.87	7.00	7.10	7.20	7.15	7.10
Hong Kong	7.85	7.85	7.83	7.85	7.85	7.85	7.84	7.83
India	65.2	68.5	72.5	74.0	75.0	76.0	77.0	78.0
Indonesia	13728	14330	14901	15300	15450	15600	15750	15900
Malaysia	3.86	4.04	4.14	4.20	4.25	4.30	4.28	4.25
Philippines	52.2	53.4	54.0	54.5	55.0	55.5	56.0	56.5
Singapore	1.31	1.36	1.37	1.40	1.42	1.44	1.43	1.42
South Korea	1064	1115	1110	1160	1180	1200	1190	1180
Thailand	31.2	33.0	32.3	33.0	33.5	34.0	33.8	33.5
Vietnam	22775	22938	23320	23400	23500	23600	23550	23500
Australia	0.77	0.74	0.72	0.70	0.68	0.66	0.67	0.68
Eurozone	1.23	1.17	1.16	1.12	1.10	1.08	1.09	1.10
Japan	106	111	114	114	116	118	117	116
United Kingdom	1.40	1.32	1.30	1.28	1.26	1.24	1.23	1.22

Australia, Eurozone and United Kingdom are direct quotes

Rates forecasts

		2018 Q1a	Q2a	Q3a	Q4	2019 Q1	Q2	Q3	Q4
US	3m Libor	2.31	2.34	2.40	**2.70**	2.95	3.20	3.45	**3.70**
	2Y	2.27	2.53	2.82	**2.90**	3.05	3.20	3.35	**3.50**
	10Y	2.74	2.86	3.06	**3.20**	3.30	3.50	3.60	**3.60**
	10Y-2Y	47	33	24	**30**	25	30	25	**10**
Japan	3m Tibor	0.07	0.07	0.07	**0.05**	0.05	0.05	0.05	**0.05**
	2Y	-0.13	-0.12	-0.11	**-0.10**	-0.08	-0.05	-0.03	**0.00**
	10Y	0.05	0.04	0.13	**0.20**	0.20	0.20	0.20	**0.20**
	10Y-2Y	18	15	24	**20**	18	15	13	**10**
Eurozone	3m Euribor	-0.33	-0.32	-0.32	**-0.30**	-0.30	-0.20	-0.10	**0.00**
	2Y	-0.60	-0.67	-0.52	**-0.10**	0.00	0.10	0.20	**0.30**
	10Y	0.50	0.30	0.47	**0.80**	1.00	1.15	1.25	**1.35**
	10Y-2Y	110	97	99	**90**	100	105	105	**105**
Indonesia	3m Jibor	5.36	7.10	7.35	**7.00**	7.00	7.00	7.00	**7.00**
	2Y	5.51	7.58	7.70	**7.70**	7.80	7.90	7.95	**8.00**
	10Y	6.68	7.80	8.12	**8.30**	8.40	8.50	8.55	**8.60**
	10Y-2Y	117	22	42	**60**	60	60	60	**60**
Malaysia	3m Klibor	3.69	3.69	3.69	**3.65**	3.65	3.65	3.65	**3.65**
	3Y	3.45	3.62	3.60	**3.75**	3.75	3.75	3.75	**3.75**
	10Y	3.94	4.20	4.07	**4.20**	4.25	4.30	4.35	**4.40**
	10Y-3Y	50	58	47	**45**	50	55	60	**65**
Philippines	3m PHP ref rate	4.08	4.01	4.87	**4.90**	5.15	5.30	5.30	**5.30**
	2Y	4.16	4.79	6.20	**5.40**	5.55	5.70	5.70	**5.70**
	10Y	6.00	6.41	7.39	**6.80**	6.90	7.00	7.00	**7.00**
	10Y-2Y	184	162	120	**140**	135	130	130	**130**
Singapore	3m Sibor	1.45	1.52	1.64	**1.85**	2.10	2.30	2.55	**2.70**
	2Y	1.79	1.96	1.95	**2.05**	2.20	2.30	2.45	**2.50**
	10Y	2.29	2.53	2.50	**2.65**	2.70	2.85	2.90	**2.90**
	10Y-2Y	50	57	55	**60**	50	55	45	**40**
Thailand	3m Bibor	1.57	1.58	1.59	**1.60**	1.85	2.10	2.35	**2.60**
	2Y	1.32	1.69	1.89	**1.60**	1.80	2.00	2.20	**2.40**
	10Y	2.40	2.58	2.80	**2.70**	2.80	2.90	3.00	**3.00**
	10Y-2Y	107	89	91	**110**	100	90	80	**60**
China	1 yr Lending rate	4.35	4.35	4.35	**4.35**	4.35	4.35	4.35	**4.35**
	3Y	3.56	3.32	3.19	**3.30**	3.40	3.50	3.60	**3.70**
	10Y	3.75	3.48	3.63	**3.70**	3.75	3.80	3.85	**3.90**
	10Y-3Y	19	16	44	**40**	35	30	25	**20**
Hong Kong	3m Hibor	1.21	2.10	2.28	**2.40**	2.65	2.90	3.05	**3.20**
	2Y	1.42	1.90	2.25	**2.35**	2.60	2.85	3.00	**3.15**
	10Y	1.99	2.25	2.47	**2.60**	2.75	3.00	3.10	**3.15**
	10Y-2Y	57	34	23	**25**	15	15	10	**0**
Korea	3m CD	1.65	1.65	1.65	**1.65**	1.65	1.90	1.90	**2.15**
	3Y	2.22	2.12	2.00	**2.05**	2.10	2.15	2.20	**2.25**
	10Y	2.62	2.56	2.36	**2.45**	2.55	2.65	2.75	**2.80**
	10Y-3Y	41	43	35	**40**	45	50	55	**55**
India	3m Mibor	7.48	7.36	7.60	**7.55**	7.55	7.55	7.55	**7.55**
	2Y	6.85	7.54	7.84	**7.85**	7.85	7.85	7.85	**7.85**
	10Y	7.40	7.90	8.02	**8.10**	8.20	8.30	8.40	**8.50**
	10Y-2Y	55	36	18	**5**	15	25	35	**45**

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

Group Research

Economics & Strategy

Taimur Baig, Ph.D.
Chief Economist - G3 & Asia
+65 6878-9548 taimurbaig@dbs.com

Nathan Chow
Strategist - China & Hong Kong
+852 3668-5693 nathanchow@dbs.com

Masyita Crystallin, Ph.D.
Economist – Indonesia & Philippines
+62 21-2988-4003 masyita@dbs.com

Joanne Goh
Regional equity strategist
+65 6878-5233 joannegohsc@dbs.com

Neel Gopalakrishnan
Credit Strategist
+65 68782072 neelg@dbs.com

Eugene Leow
Rates Strategist - G3 & Asia
+65 6878-2842 eugeneleow@dbs.com

Chris Leung
Economist - China & Hong Kong
+852 3668-5694 chrisleung@dbs.com

Ma Tieying, CFA
Economist - Japan, South Korea, & Taiwan
+65 6878-2408 matieying@dbs.com

Radhika Rao
Economist – Eurozone, India & Thailand
+65 6878-5282 radhikarao@dbs.com

Irvin Seah
Economist - Singapore, Malaysia, & Vietnam
+65 6878-6727 irvinseah@dbs.com

Samuel Tse
Economist - China & Hong Kong
+852 3668-5694 samueltse@dbs.com

Duncan Tan
FX and Rates Strategist - Asean
+65 6878-2140 duncantan@dbs.com

Philip Wee
FX Strategist - G3 & Asia
+65 6878-4033 philipwee@dbs.com

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