Monthly Economic Review

Interest Rate Hike Cycle Peaking

US rate hike is reaching its peak

Fed rates to stay high and tread cautiously

- August's Jackson Hole meeting saw the Fed remained focus on the 2% inflation target. They remain worried on the recent data strength that indicates the "economy may not be cooling as expected and could put further progress on inflation" leading to more tightening.

- Still the overall narratives of the Jackson Hole meeting suggests the Fed is likely to maintain the policy rate range 5.25-5.50% during the 19-20 September's meeting after a 25bps in July to 5.25%-5.50%. The probability for a rate hike in September is low at 30% chance.

- For instance, the headline inflation rose 3.2%y/y in July (+3.0% y/y in June) halt the 12 consecutive months of declines was due to base effects. Core inflation (excluding food and fuel prices) grew slower by 4.7% y/y in July (+4.8% y/y in June) – the lowest in 22 months.

- Higher producer inflation, up +0.8% y/y in July (+0.2% y/y in June) was also due to base effects. Core producer inflation remained stable at 2.4% y/y in July for the second month – the lowest since January 2021.

- Job market added 187K jobs in July (June: 185K) was below forecast of 200k. Unemployment eased to 3.5% in July (3.6% in June) with average hourly earnings grew steady at 4.4% y/y, the same pace as in June.

US – Real Economy

Signs of moderation is emerging

- The manufacturing PMI worsened to 47 in August from 49 in July – second weakest reading since January 2023. It was due to lower output and a more pronounced drop in new orders.

- Also, the services PMI slipped to 51 in August from 52.3 in July – slowest expansion in 6 months. The drag came from new business activities inflicted by the high borrowing cost and inflationary pressure.

- Personal spending rose 0.5% m/m in July (+0.7% m/m in June) and personal income was unchanged at 0.3% m/m in July. And the preliminary Michigan Consumer Sentiment slipped to 69.5 in August from 71.6 in July.

- But retail sales came in stronger-than-expected. It beat estimates of 0.4%m/m to report 0.7% m/m. Excluding autos, sales grew by 1% against a 0.4% forecast. Both readings were the best monthly gains since January.

- Current macro indicators suggests there are growing signs of a cooling trend as the economy moves ahead. Thus, the Fed is expected to reduce the policy rate by 150bps - 200bps in 2024 to support the economy.

US - Key Indicators

Chart 1: CPI & Core-CPI (y/y %)

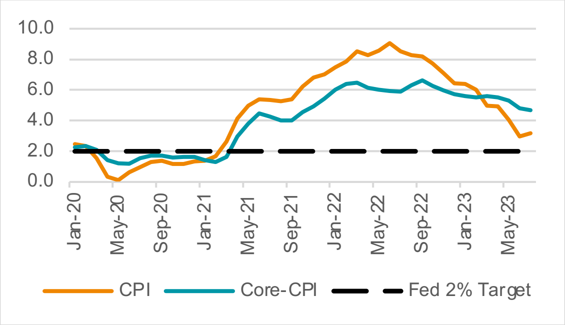


Chart 2: Average Hourly Earnings (y/y %)

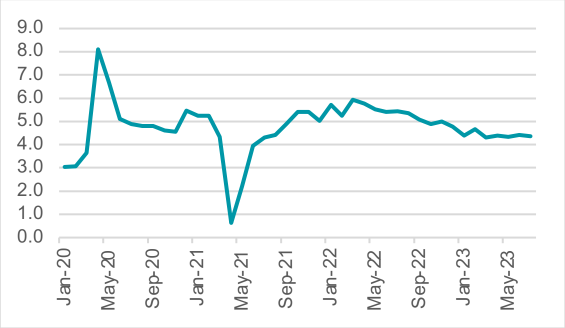


Chart 3: Fed Fund Rate – Upper Limit (%)

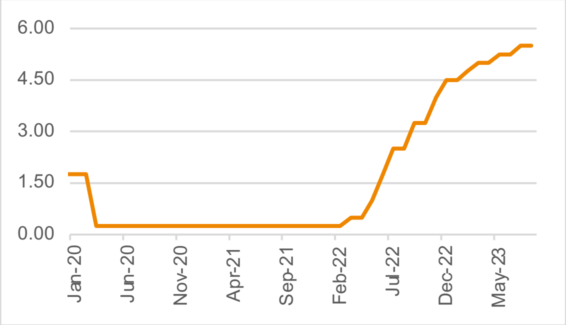


Chart 4: Unemployment Rate (%)

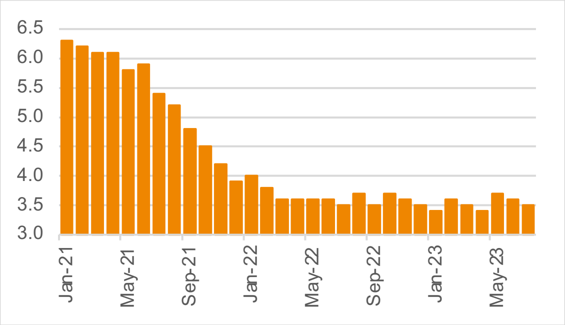


Chart 5: Industrial Production (y/y %)

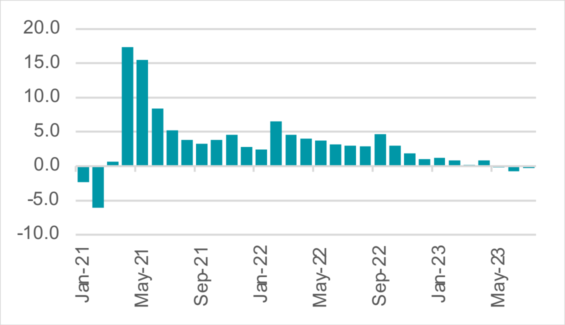
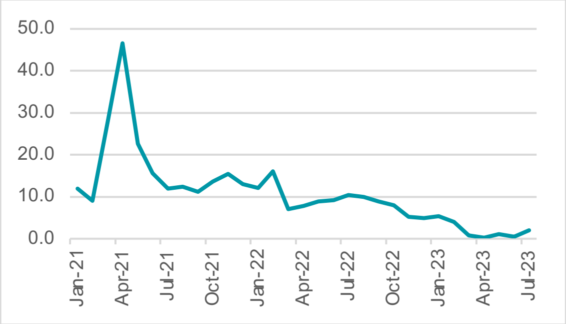


Chart 6: Retail Trade (y/y %)



Source: St. Louis Fed/Trading Economics

Euro Area – Monetary Indicators

ECB rates to stay high and pace carefully.

- There was no monetary policy meeting by the ECB in August. The ECB next meeting on 14 September will likely witness a pause to a more than year-long rate-hiking campaign.
- The ECB President in a news conference after July's 25bps hike did pave way for a pause: "Do we have more ground to cover? At this point in time, I wouldn't say so."
- A further hike by end 2023 is still on the cards. It depends on the incoming data. If one more hike as we narrowly predict materialises, the deposit rates would be the highest since the euro was introduced in 1999.
- July's headline inflation grew by 5.3% y/y (June: 5.5% y/y) – slowest since January 2022 due to base effects. Core inflation (minus energy, food, alcohol & tobacco prices) grew 5.5% y/y in July, same pace as in June.
- Producer prices fell by 3.4% y/y in June (-1.6% y/y in May) – second straight and steepest decline since June 2020 was dragged by energy prices (-16.5% y/y vs May -13.5% y/y).
- Unemployment rate remained stable at a record low of 6.4% in June for the third month. Wage growth in 1Q23 in euro region was 4.6% while the non-wage component rose by 6.2%.

Euro Area – Real Economy

High interest rates and inflation waning confidence

- The manufacturing PMI rose to 43.7 in August from the three-year low of 42.7 in July. It has been in the contraction region for 14 consecutive months. Drag came from new orders and output.

- Services PMI fell to 48.3 in August from 50.9 in July, first contraction since end 2022 due to worsening demand with new business intakes down at a pace not seen since May 2013 if we exclude COVID-19 lockdown months.

- The Euro Area ZEW Economic Sentiment Index fell -5.5 in August (-12.2 in July) while the preliminary August Consumer Confidence index plunged to -16 from -15.1 in July from high interest rates and inflation.

- Retail sales fell 0.3% m/m in June(+0.6% m/m in May) while on y/y it declined by 1.4% from -2.4% y/y in May.

- The 2Q23 GDP grew by 0.3% q/q from a flat 1Q23 is most likely being bolstered by a moderation in inflationary pressures. But on y/y%, it slowed to 0.6% from 1.1% in 1Q23 as high interest rates and inflation are diminishing confidence and continued to weigh on the economy.

Euro Area - Key Indicators

Chart 7: CPI & Core-CPI (y/y %)

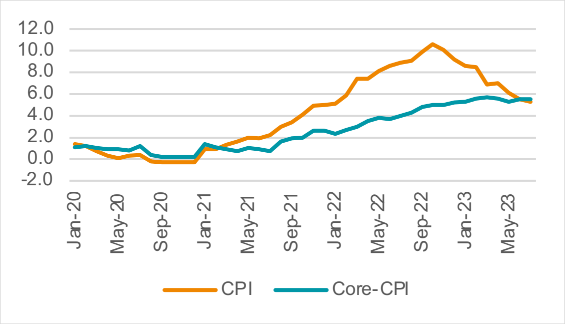


Chart 8: PPI (y/y %)

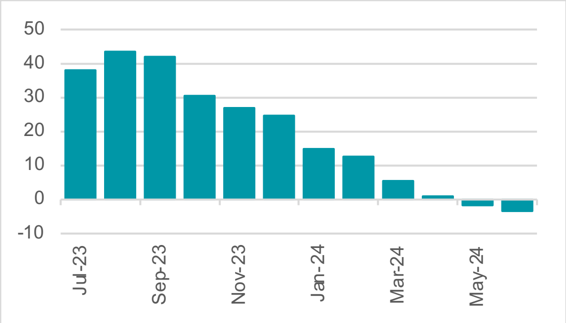


Chart 9: ECB Main Refinancing Rate (%)

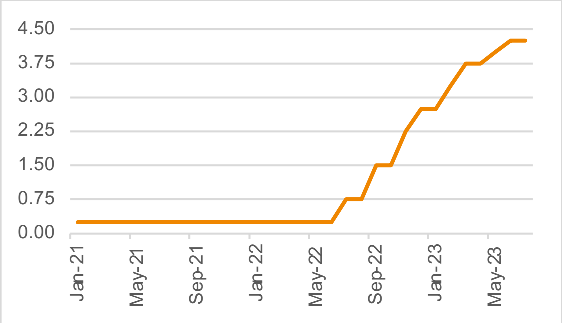


Chart 10: Unemployment Rate (%)

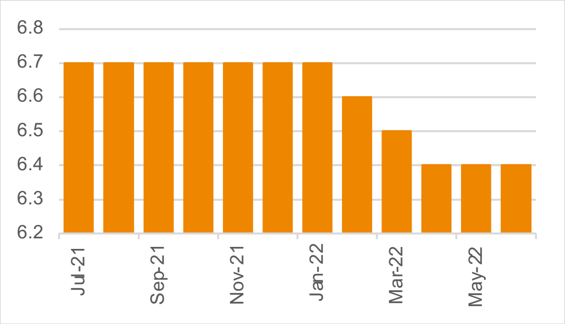


Chart 11: Industrial Production (y/y %)

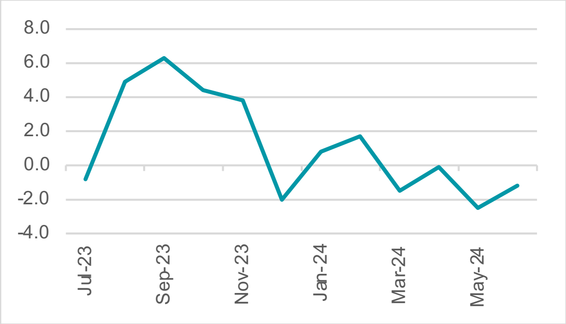
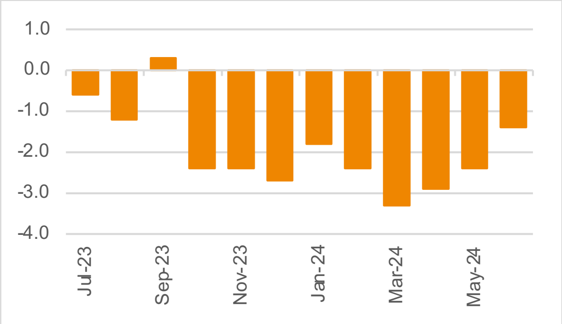


Chart 12: Retail Trade (y/y %)



Source: St. Louis Fed/Trading Economics

China – Monetary Indicator

Beijing has limited room for deeper monetary easing.

- The PBoC remains as the outlier among the major global central banks as it continues to loosen its monetary policy to support the weak economy.

- PBoC reduced: 1-year Medium Term Lending Facility (MLF) Rate by 15bps to 2.50%, 7-day reverse repo rate by 10bps to 1.80%, 1-year Loan Prime Rate by 10bps to 3.45% but kept the 5-year Loan Prime Rate at 4.20%.

- Effectiveness of the looser credit conditions in the near term remains to be seen with both the consumer and business confidence subdued. The limited size and scope of rate cuts suggests PBoC is concern about downward pressure on the yuan. Widening yield differentials with major economies would trigger yuan selloffs and capital flight. Beijing has limited room for deeper monetary easing,

- Inflation fell 0.3% y/y in July from a flat reading in June – first decline since February 2021 due to base effects. Core inflation (excludes food and energy prices) rose 0.8%y/y in July (+0.4%y/y in June) – fastest since January.

- Factory gate inflation fell by -4.4% y/y in July (-5.4% y/y in June) – steepest fall since December 2015. But the smaller fall was due to base effects and recent rebound in some commodity prices. Unemployment rate rose to 5.3% in July (June's 16-month low of 5.2%) .

China – Real Economy

More downside risk to the economy.

- Caixin manufacturing PMI slipped to 49.2 in July from 50.5 in June – lowest reading in six months. New orders dropped, foreign sales contracted, and the buying levels fell.

- But the Caixin services PMI rose to 54.1 in July from June's five-month low of 53.9. It grew from the seventh straight month in services activity from pick up in new orders and job creation.

- Softer July's industrial production, up by 3.7% y/y (+4.4% y/y in June) was dragged by manufacturing (3.9% y/y; June: 4.8% y/y) and mining (1.3% y/y; June: 1.5% y/y). Retail sales grew slower by 2.5% y/y in July (3.1% y/y in June) while fixed-asset investment grew by 3.4% y/y in the first seven months of 2023 from a +3.8% y/y in 1H23.

- Exports plunged by 14.5% y/y to a five-month low in July (June: -12.4% y/y) – steepest decline since February 2020 with poor demand from the US fell 23.1%y/y, ASEAN and EU it plunged by 21.4%y/y and 20.6% y/y, respectively.

- There is more downside risk to the economy from a raft of weak indicators. The GDP is more likely to be around 4% as the weaker-than-expected growth momentum in major countries plus domestic policies will make things difficult to set for high growth.

China - Key Indicators

Chart 13: CPI (y/y %)

Chart 14: PPI (y/y %)

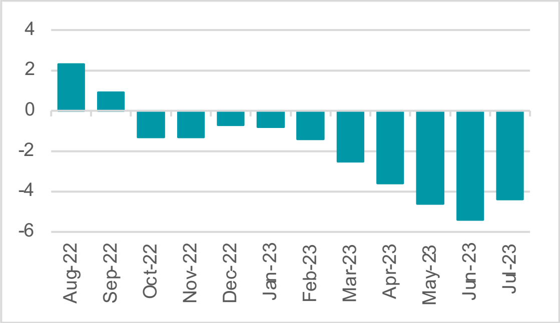


Chart 15: 1-year Loan Prime Rate (%)

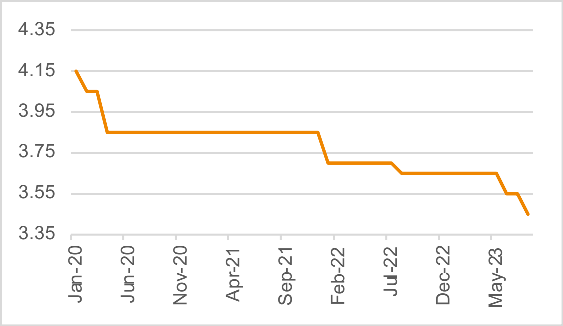


Chart 16: Unemployment Rate (%)

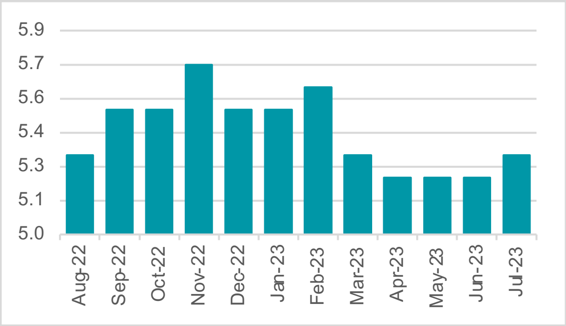


Chart 17: Industrial Production (y/y %)

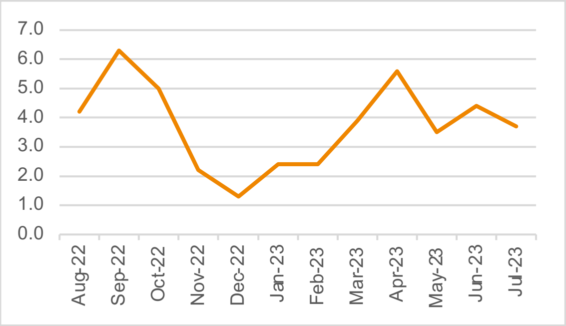
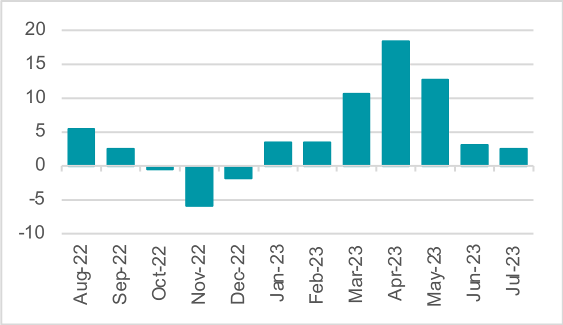


Chart 18: Retail Trade (y/y %)



Source: St. Louis Fed/Trading Economics

Malaysia – Monetary Indicators

OPR is expected to remain unchanged

- There was no monetary policy meeting in August. The next policy meeting is on 7 September. The OPR would remain slightly accommodative at 3.00% and stay at this level for the next six to 12 months.

- Persistent downward trajectory of both headline and core inflation, remain supportive to the economy, limited risks of future financial imbalances and potential stronger ringgit as the Fed turns dovish, disinflationary dynamics and weaker labour market in 4Q23 would bode well.

- Headline inflation slowed down to 2.0% y/y in July (+2.4% y/y in June), lowest since September 2021 due to base effects. Core inflation eased to 2.8% y/y in July (+3.1% y/y in June).

- Producer prices (PPI) fell by 2.3% y/y in July (-4.8% y/y in June), the slowest fall since February 2023 and six straight months of contraction dragged by weak manufacturing sector prices, down 2.4% y/y (June: -1.8% y/y)

- Labour market remained healthy with unemployment rate edged lower to 3.4% in June (+3.5% in May). The created 28K jobs in June (28.1K jobs in May).

Malaysia – Real Economy

Unlikely to be in recession

- July manufacturing PMI rose to 47.8 from June's five-month low of 47.7 but remains in the contraction region for the 11 consecutive month. New orders moderated. Export orders dropped. Production output remained muted.

- Industrial production fell 2.2% y/y in June 2023 (+4.7% y/y in May). Manufacturing fell by 1.6% y/y (May: +5.1% y/y) drag by petroleum, chemical, rubber, plastic products, E&E, wood products, furniture, paper products and printing. Wholesale and retail market showed slower June's distributive trade grew slower by 3.1% y/y (+4.6% y/y in May).

- But retail sales came in slightly faster at 2.5% y/y in June (+2.4% y/y in May). Exports fell for the fifth month by -13.1% y/y in July (-14.1% y/y in June) hurt by slower global trade.

- The 2Q23 GDP grew slower by 2.9% y/y (+5.6%y/y in 1Q23) from base effect. But 2H23 outlook would be supported by private consumption and investment, broad-based consumers spending, strong labour market from broad-based improvement across different sectors, DDIs, FDI, and MSMEs.

- And domestic demand to benefit from the 'Madani economy' – launch the second phase of the National Energy Transition Roadmap, National Industrial Master Plan, 2024 Budget scheduled on 13 October.

Malaysia – Key Indicators

Chart 19: Headline CPI (y/y %)

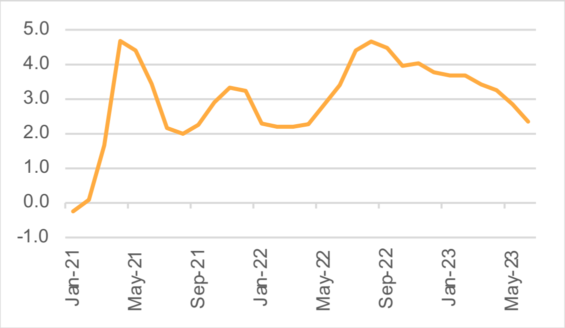


Chart 20: PPI (y/y %)

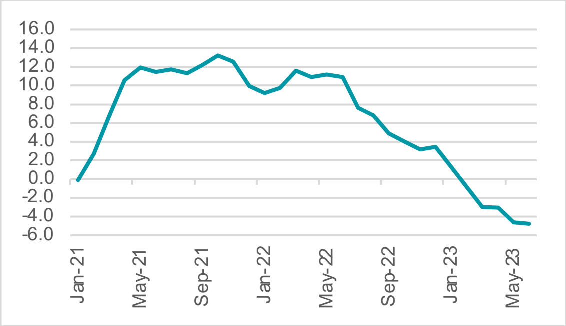


Chart 21: Overnight Policy Rate (%)

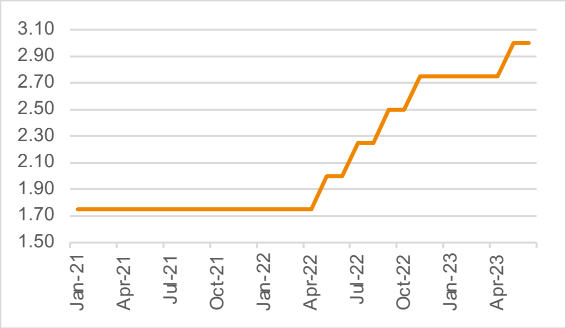


Chart 22: Unemployment Rate (%)

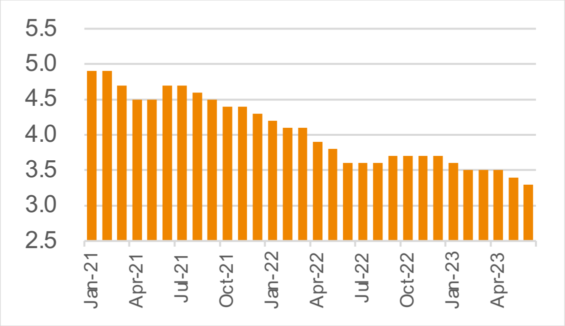


Chart 23: Industrial Production(y/y %)

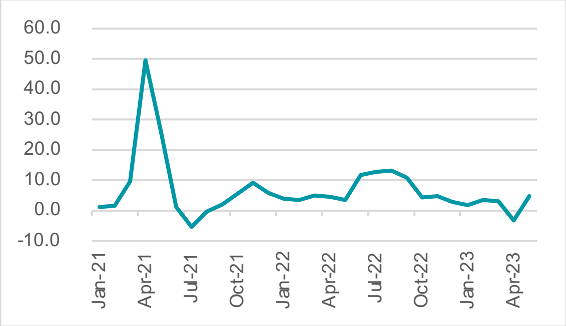
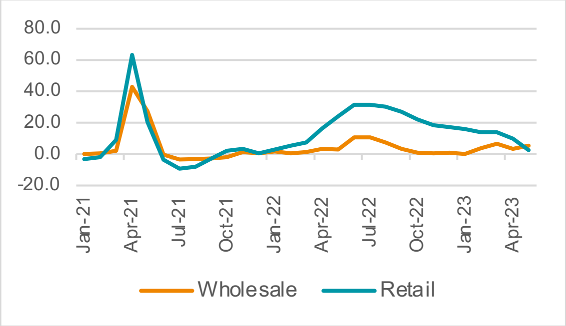


Chart 24: Wholesale & Retail Trade (y/y %)



Source: BNM/DOSM

Currency Outlook

Dollar dominance is expected to fizzle

- The dollar's dominance remained across the board – gained 2.16% to 104.1 during the month due to global risk-off sentiment as investors were busy repricing the Fed's interest rate outlook.

- But the dollar play is expected to give up some steam in the coming months. There are growing signs that the Fed rate hike cycle is coming to its peak as inflation eases and credit condition gets tighter.

- The new narrative would be on the US economy – soft or hard landing. Like all other currencies, Malaysian Ringgit (MYR) fell by 1.88% to 4.64. The MYR in the near term is likely to trade around 4.58-4.64 levels.

- Going forward, the scope for a weaker dollar is clearly intact. There is even a risk of a pretty large move in a weaker direction for the dollar. The dollar could weaken by as much as 15-25% over 2024 and 2025.

- Such weakening of dollar bodes well for MYR. But BNM may try to "fight gravity" through some intervention to prevent the pair from strengthening too fast for a while before allowing it to run its course in 2024 and 2025. We aim for (at least) < 4.30 levels in USDMYR in 2024.

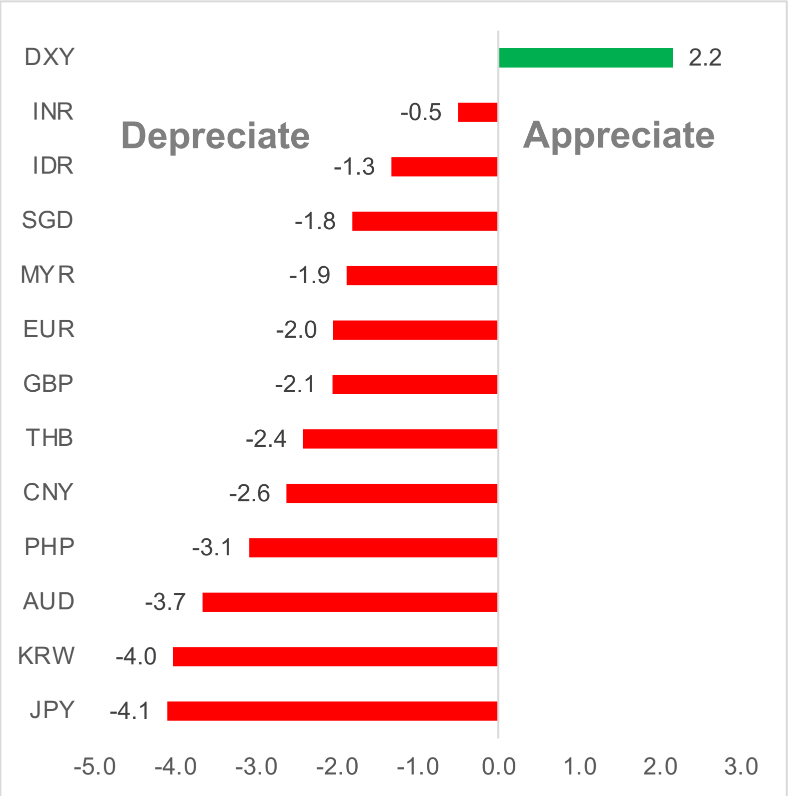
Note: Month-to-date currency performance is as of 28 Aug 2023

Currency Outlook

Chart 25: Dollar Index (Year-to-date)

Chart 26: USD/MYR (Year-to-date)

Chart 27: Currencies against the dollar (Month-to-date)*



***Note: Month to date performance is as of 28 Aug 2023**; Source: Bloomberg/Yahoo Finance

KSI STRATEGIC INSTITUTE FOR ASIA PACIFIC

CALENDAR FOR SEPTEMBER

Date	Country	Event
4-7 Sep-23	ID	ASEAN Leaders' Summit
		Regional Comprehensive Economic Partnership (RCEP) Summit
07-Sep-23	**MY**	**BNM Interest Rate Decision**
08-Sep-23	MY	Unemployment Rate
09-Sep-23	CH	Inflation Rate
9-10 Sep-23	IN	G20 Leaders' Summit
11-Sep-23	MY	Industrial Production
	MY	Retail Sales
13-Sep-23	US	Inflation Rate
14-Sep-23	**EA**	**ECB Interest Rate Decision**
16-Sep-23	MY	Malaysia Day (Holiday)
19-Sep-23	MY	Trade Data - Export & Import
20-Sep-23	**CH**	**1Y & 5Y Loan Prime Rate**
	US	**Fed Interest Rate Decision**
		FOMC Economic Projection
		Fed Press Conference

CALENDAR FOR SEPTEMBER cont'

Date	Country	Event
21-Sep-23	**UK**	**BOE Interest Rate Decision**
	PH	**BSP Interest Rate Decision**
	ID	**BI Interest Rate Decision**
22-Sep-23	**JP**	**BOJ Interest Rate Decision**
	MY	Inflation Rate
27-Sep-23	**TH**	**BOT Interest Rate Decision**
28-Sep-23	MY	Maulidur Rasul (Holiday)
	EA	ECB General Council Meeting
	FR	IEA Critical Minerals & Clean Energy Summit
TBD	CH	Politburo Meeting