

MARKET SUMMARY

| FX | CLOSE(Asia) | CLOSE(NY) | Daily Δ* | Wkly Δ |
|-----|-------------|-----------|----------|---------|
| JPY | 131.59 | 129.25 | ▼3.20 | ▼4.16 |
| EUR | 1.0763 | 1.0853 | +0.0096 | +0.0331 |
| AUD | 0.6901 | 0.6969 | +0.0065 | +0.0217 |
| SGD | 1.3307 | 1.3252 | ▼0.0060 | ▼0.0203 |
| CNY | 6.7584 | 6.7295 | ▼0.0355 | ▼0.1509 |
| INR | 81.66 | 81.55 | ▼0.02 | ▼1.00 |
| IDR | 15338 | 15339 | ▼143 | ▼278 |
| MYR | 4.3655 | 4.3593 | ▼0.0120 | ▼0.0295 |
| PHP | 55.33 | 55.31 | +0.50 | ▼0.47 |
| THB | 33.43 | 33.17 | ▼0.27 | ▼0.87 |

*compared with previous day CLOSE(NY)

| Govt Bond Yields | CLOSE | Daily Δ | Wkly Δ |
|------------------|--------|----------|----------|
| USD (10YR) | 3.440% | ▼9.9 bp | ▼27.8 bp |
| JPY (10YR) | 0.510% | +0.5 bp | +7.6 bp |
| EUR* (10YR) | 2.159% | ▼4.5 bp | ▼15.7 bp |
| AUD (5YR) | 3.350% | ▼13.4 bp | ▼25.0 bp |
| SGD (5YR) | 2.738% | ▼0.7 bp | ▼3.5 bp |
| CNY (5YR) | 2.679% | ▼0.9 bp | +7.0 bp |
| INR (5YR) | 7.143% | ▼0.7 bp | ▼8.9 bp |
| IDR (5YR) | 6.411% | ▼5.5 bp | ▼21.1 bp |
| MYR (5YR) | 3.799% | ▼0.7 bp | +1.9 bp |
| PHP (5YR) | 6.178% | ▼21.7 bp | ▼29.6 bp |
| THB (5YR) | 1.930% | +0.3 bp | ▼5.4 bp |

* German bunds

| Equity Indices | CLOSE | Daily Δ | Wkly Δ |
|----------------|-----------|---------|--------|
| DJIA (US) | 34,189.97 | +0.64% | +3.83% |
| N225 (JP) | 26,449.82 | +0.01% | +2.44% |
| STOXX 50 (EU) | 4,126.68 | +0.66% | +4.22% |
| ASX (AU) | 4,264.75 | +0.99% | +2.06% |
| STI (SG) | 3,267.78 | ▼0.11% | ▼0.76% |
| SHCOMP (CN) | 3,163.45 | +0.05% | +0.26% |
| SENSEX (IN) | 59,958.03 | ▼0.25% | ▼0.65% |
| JSE (ID) | 6,629.93 | +0.69% | ▼0.36% |
| KLSE (MY) | 1,488.66 | +0.05% | +0.52% |
| PSE (PH) | 6,833.53 | +1.85% | +1.07% |
| SET (TH) | 1,687.45 | +0.10% | +1.42% |

| Commodity | CLOSE | Daily Δ | Wkly Δ |
|---------------|----------|---------|--------|
| CRB | 273.77 | +0.92% | +3.82% |
| COPPER (LME) | 9,169.05 | +0.68% | +9.66% |
| IRON ORE (CN) | 122.03 | +0.44% | +5.02% |
| GOLD | 1,897.09 | +1.14% | +3.50% |
| OIL (WTI) | 78.39 | +1.27% | +6.41% |

TODAY'S COMMENTS & FORECAST

Open

| | | | |
|---------|--------|---------|--------|
| USD/JPY | 129.16 | EUR/USD | 1.0860 |
| USD/SGD | 1.3226 | USD/THB | 33.12 |
| JPY/SGD | 1.0240 | USD/MYR | 4.359 |

Forecast

| | |
|---------|-----------------|
| USD/JPY | 128.60 - 130.30 |
| EUR/USD | 1.0740 - 1.0930 |
| AUD/USD | 0.6880 - 0.7030 |
| USD/SGD | 1.3190 - 1.3270 |
| JPY/SGD | 1.0123 - 1.0319 |
| USD/CNH | 6.7000 - 6.7400 |
| USD/INR | 81.25 - 81.80 |
| USD/IDR | 15250 - 15450 |
| USD/MYR | 4.330 - 4.368 |
| USD/PHP | 54.60 - 55.40 |
| USD/THB | 32.95 - 33.40 |

Today's Direction

| | Bull | Bear |
|---------|------|------|
| USD/SGD | 2 | 4 |
| USD/JPY | 2 | 4 |

Three Take-aways:

- 1) Sustained US CPI decline (one-year low) sets off pivot bets; lifts equities; cuts yields; sinks USD.
- 2) Inner most layer of core services ex-shelter remains sticky; warning of excessive optimism.
- 3) BoK on course for one more 25bp hike. And despite USD drop, scope for CNH gains overstated.

Of Ogres & Inflation

"Ogres are like onions ... Layers! ... Onions have layers ... Ogres have layers." - Shrek

- Turns out, Fed Chair Powell's point is that **inflation is like an Ogre**; with the complexities of **layers to contend with**. Let's hold that thought and get back to it in a bit.

- Moreover, at times, not unlike an Ogre, inflation may be *scary enough to incite forceful and visceral reaction from central bankers*. To that end, **relief may be as sharp as fear**.

- And with December's US CPI easing, further this **relief is precisely what was on display**.

- With a sixth straight easing in headline CPI from 9.1% to 6.5% and a third successive decline in core inflation from 5.3% to 4.5%, **markets seized and amplified Fed pivot bets**; starting with Feb FOMC being anchored with a dial-back to 25bp hike and mid-2023 peak rate below 5%.

- In response to the prospects of less aggressive Fed tightening, equities rallied (S&P500: +0.3%; Nasdaq: +0.6%); and UST yields tumbled led by the long-end (10Y: -10bp to 3.44%; 2Y: -7bp to 4.15%).

- The **Greenback stumbled** (DXY Index from 103+ to low-102) in deference to Fed pivot play.

- This saw level changes in FX land; EUR up a big figure to mid-1.08; AUD rising above mid-0.69; USD/JPY sliding below mid-129 and USD/SGD buckling to low-1.32.

- Admittedly, **market relief is grounded** on solidifying evidence of dis-inflation squaring with the Fed approaching the end of its tightening cycle. But the **layers of inflation suggest that markets may be overly optimistic about "pivot"**. *How the layers unravel* tell us why.

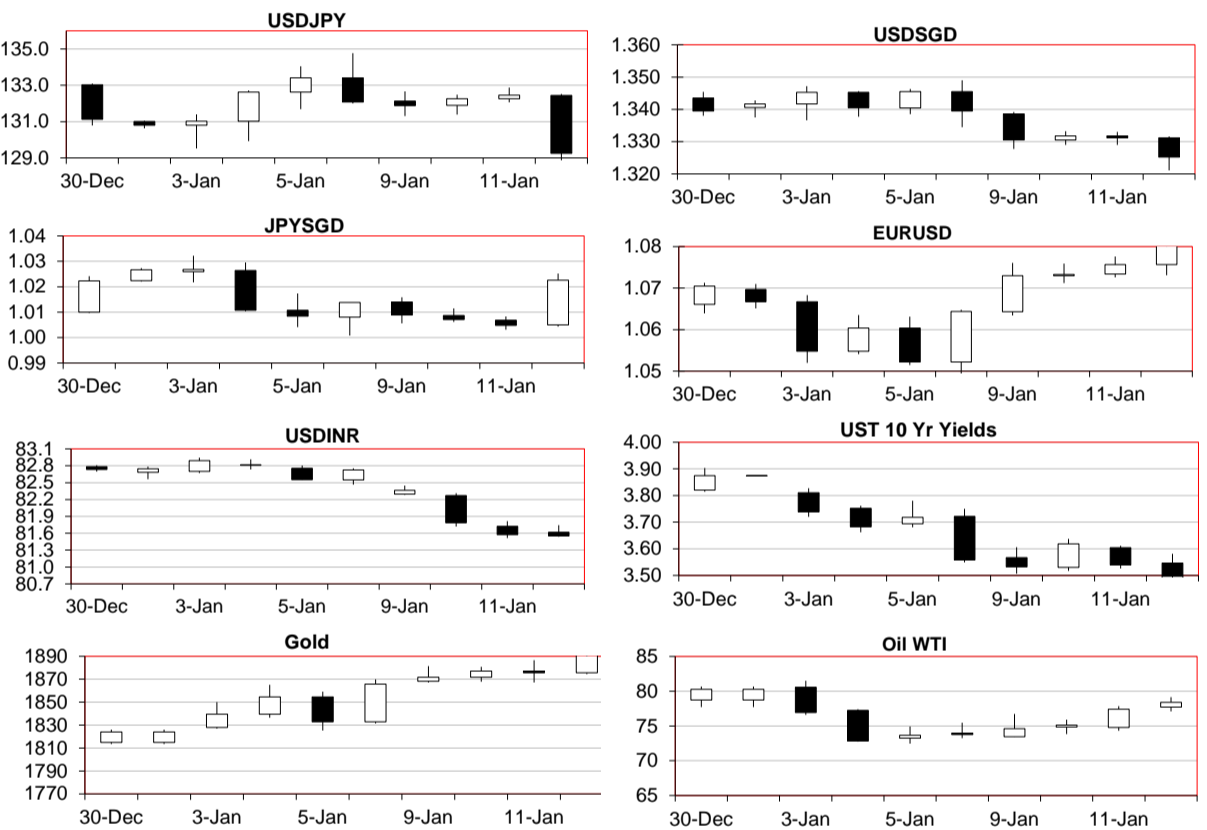
- Sustained fuel dis-inflation diminishing the headline and outright deflation of core goods while welcome are not pivotal. Whereas *core services ex-rental*, the **inner most layer of inflation that Fed is most concerned about remains uncomfortably sticky**.

- And that may set the stage for markets to be knocked back from **"unwarranted" optimism** and the attendant loosening of financial conditions.

OVERNIGHT RESULTS

(CH) CPI/PPI YoY (Dec): 1.8%/-0.7% (Mkt: 1.8%/-0.1%; Nov: 1.6%/-1.3%) | (IN) CPI YoY (Dec): 5.7% (Mkt: 5.9%; Nov: 5.9%)
(US) CPI/Core YoY (Dec): 6.5%/5.7% (Mkt: 6.5%/5.7%; Nov: 7.1%/6.0%)

Past Two Weeks Movement



- In turn, this informs us that **peak USD trades may be bumpy**, depending on the layers of inflation at work; **warranting caution on extended short USD/AXJ and long risk bets**.

- Elsewhere, the BoK is set to hike by 25bp to 3.50% in what is likely to be peak tightening; unlike the Fed, which probably has more work to do.

Un-Real-istic Bullish CNH Expectations

- A quick glance at **real yield spreads between CBGs and USTs suggests significant upside potential for the CNH**. But this is at best overstated, if not misleading.

- For the record, a literal read of *juxtaposed real (CGB-UST) yield spreads and CNH** suggests that CNH could rise as high (USD/CNH as low) as 6.20. But this is unrealistic.

- For a start, the chart correlating real CGB-UST 2Y spreads and CNH is not meant to be deciphered literally. So inferred scope for appreciation is certainly overstated.

- More importantly, there are **three key pitfalls in assuming that CNH is poised to materially exploit scope for appreciation implied by real CGB-UST yield spreads** (in favour of CNH).

- **First**, peaking US inflation means that **backward-looking inflation spreads overstate implied CNH advantage**. **Second**, sustained policy divergence, not fully reflected in the real yield spreads, also overstate scope for CNH gains.

- **Finally**, and most importantly, **real yield spreads fail to account for material, and arguably mounting, risk premium** (both economic and geo-political) **that will stifle CNH gains**.

- And so, unchallenged CNH gains may be derailed, and accordingly a smaller bullish CNH tide may not lift other EM Asia FX currencies by as much.

FX Daily Outlook

- EUR/USD: With post-CPI Fed pivot bets engaged, 1.09 is the next barrier above.
- USD/JPY: Softer UST yields and Greenback setting the stage for potential sub-129 test.
- USD/SGD: A slip below 1.32 is not ruled out; though there is reason for restraint.
- AUD/USD: USD declines and CNH rallies setting sights on 70 cents.

TODAY'S EVENTS

(CH) Trade Balance (Dec): (Mkt: US\$76.9b; Nov: US\$69.3b) | (EZ) Industrial Production WDA YoY: (Mkt: 0.5%; Oct: 3.4%)
(US) U. of Michigan Sentiment/Current Conditions (Jan P): (Mkt: 60.5/60.0; Dec: 59.7/59.4) |
(US) U. Of Michigan 1Yr/5-10Y Inflation Expectations: (Mkt: 4.3%/2.9%; Dec: 4.4%/2.9%)
Central Banks: **BoK Policy Meeting**

* Refer to Mizuho Chart Speak - Why CNH May Not Exploit Untapped Real Yield Advantages, 12 Jan 2023 for details.

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