OCBC

GLOBAL MARKETS RESEARCH

Interest Rates Monthly

15 March 2024

Central Bank Preview: BoJ, RBA, FOMC, BoE

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- **USD rates.** For the upcoming FOMC, focuses are on the dot-plot update, on the rhetoric including any clue as to how "not far" we are from the first rate cut, and on QT plan. We do note that the December dot-plot is skewed to the upside, in that two dots moving higher would be enough to move the median dot higher. History suggests these "dots" have not been particularly accurate in predicting what would be delivered ultimately, but should the median dot move, it would move the market as well.

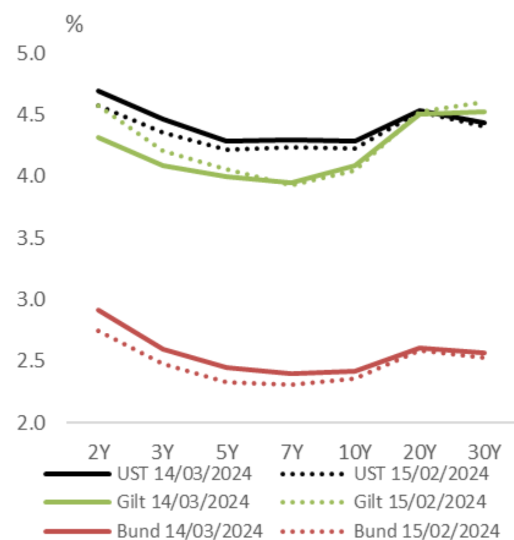
- **GBP rates**. We expect the BoE to keep the Bank Rate unchanged at its March MPC, as the central bank appears in no rush to start cutting rates. The split of the vote will again be the focus; market watch if any of the two members who voted for a hike at the February MPC will change their mind, or if there is any addition to the vote for a cut.

- **JPY rates**. It has been our long-end view that the BoJ is likely to exit NIRP as soon as this month. Robust wage growth shall give the BoJ the greenlight to start normalizing monetary policy. Our base-case is for a 10bp hike in the Policy-Rate Balance Rate. In the scenario where the YCC is removed, strong support for the 10Y JGB shall sit at the 1.1-1.2% area. We have a steepening bias on the JGB curve across the 2s10s segment.

- **AUD rates**. The RBA has not pivoted yet. The February MPC statement has even left the door open for further tightening. The market and we are not convinced that there is a material risk of additional rate hike(s). But the RBA will probably be among the last major central banks to start the easing cycle.

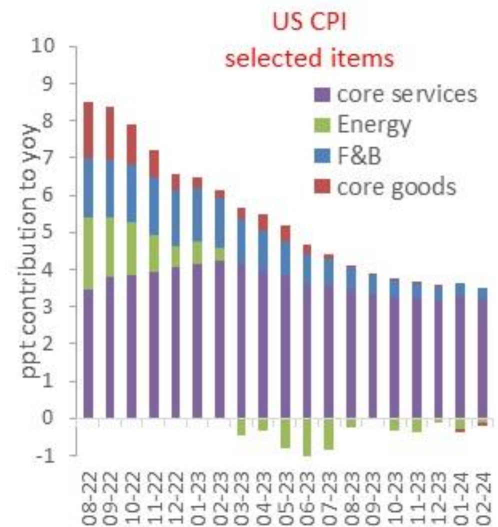
- **EUR rates**. ECB kept key policy rates unchanged at its March meeting as widely expected but nevertheless there were a couple of dovish elements, underlining our base-case for the first rate cut to come in June.

- **CNY rates**. We earlier cautioned against chasing long-end CGB yields lower. Yields have since rebounded; still, at current levels, we are at best neutral long-end CGBs on supply and reflation efforts. Supporting CGBs would be asset allocation needs, monetary policy easing expectation, and asset swap pick-ups for foreign investors.



Source: Bloomberg, OCBC Research

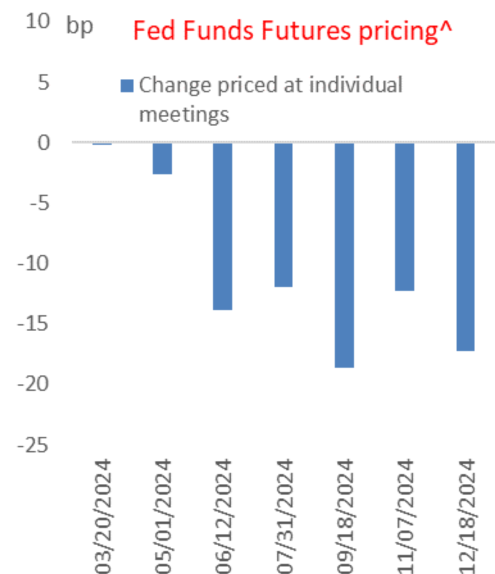
USD:
After market added to and then pared back rate cuts expectation, short-end UST yields last traded mildly higher than the levels a month ago. Fed funds futures priced a total of 77bps rate cuts this year, similar to the Fed's December median dot of 75bps. The pricing of rate cuts is fairly distributed over the months at and beyond June; we see no major dislocation among the Fed funds futures contracts but overall, pricing is a tad more hawkish than our base-case of 100bps for this year. We hold onto our view that the inflation backdrop and outlook stay conducive to the start of the easing cycle around June. The February CPI misses were marginal (at the order of the second decimal place); Headline CPI inflation edged higher to 3.15%YoY from 3.09%YoY, as the drag from energy prices almost diminished. There were pockets of relief, for example, the contribution from core services inflation to headline YoY inflation continued to ease, albeit slowly. Similarly, the rebound of PPI YoY inflation was primarily due to diminishing drag from energy prices. Market is sidelined now running into FOMC.



Source: CEIC, OCBC Research

FOMC preview. With the FOMC widely expected to keep Fed funds rate unchanged at its March meeting, focus will be on:

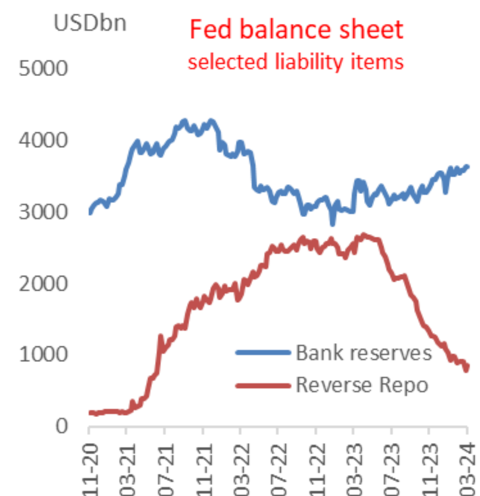
1/ The March dotplot. Market will observe if there is any change to the median dot and/or the distribution of the dots. In this relation, Fed's Kashkari was quoted saying he may consider putting one cut for the March dot-plot instead of two which he had put for the December dot-plot. Movement of dots which are not in line with the median dot is of less importance; **we focus on those dots which were on par with the December median dot**. We do note that the December dot-plot is skewed to the upside, in that two dots moving higher would be enough to move the median dot higher. History suggests these "dots" have not been particularly accurate in predicting what would be delivered ultimately, but should the median dot move, it would move the market as well.



Source: Bloomberg, OCBC Research ^15 March

2/ Hints on potential timing of the first rate cut. The FOMC is likely to again emphasise patience but given Powell mentioned the Committee is "not far" from being confident about reaching inflation target, investors will **look for clues as to how "not far" we are from the first rate cut**. With market pricing in the likelihood for a rate cut either at the June FOMC or the July FOMC meeting, we would imagine if there were any hint on the timeline it would move the needle earlier rather than later.

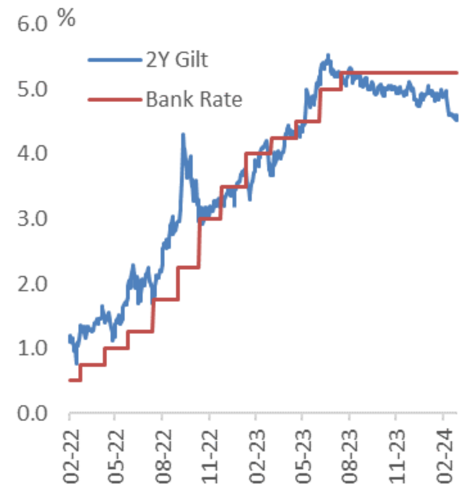
3/ QT. While our view remains that on aggregate, liquidity is enough to allow QT to continue at the current pace through most of this year, the last FOMC minutes revealed that members prefer to taper QT to help smooth the transition to an ample level of reserves when reserves are still more than ample, as it is difficult to gauge what is considered as ample.



Source: Bloomberg, OCBC Research

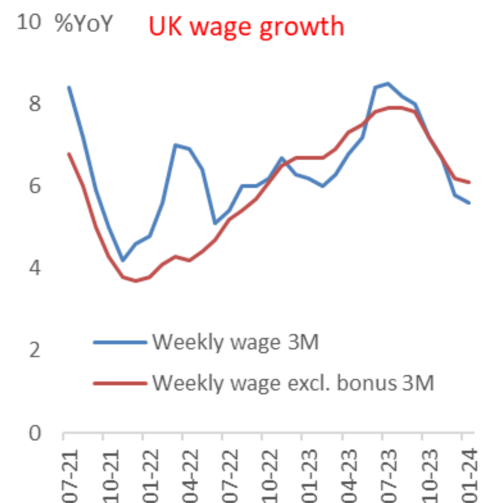
GBP:

We expect the BoE to keep the Bank Rate unchanged at its March MPC, which is also the consensus. GBP OIS price around three 25bp rate cuts for this year, in line with our base-case with the first rate cut likely materializing at the August MPC meeting. BoE Pill last commented his baseline for cutting Bank Rate remains “some way off”. Mann commented that the UK is “nowhere near” the historical relationship between core and goods inflation that is consistent with headline inflation at 2%, and that “the deceleration in services has to continue throughout the forecast horizon at a much faster pace”. Latest labour market reports point to some signs of cooling, with January averagely weekly earnings easing mildly to 5.6%YoY versus 5.8% prior, and the ILO unemployment rate edging up to 3.9% from 3.8%. On balance, the BoE appears not in a rush to start cutting rates. On the vote, market watch if any of the two members who voted for a hike at the February MPC will change mind; meanwhile, there may be addition to the vote for a cut. Overall, it is likely to be a three-way split again. A split of 1-7-1 or 2-5-2 (in terms of hike-hold-cut) would be a dovish tilt scenario.



Source: Bloomberg, OCBC Research

Earlier, Gilts investors were given a relief as there was no drama from the Spring Budget. The Net Financing Requirement (NFR) for 2024-25 is forecast at GBP265.3bn, mildly on the high side of market expectations; reliance is skewed towards short- and medium-term gilts issuances. Compared to the November forecast, borrowing is slightly higher by 0.1% of GDP on average over the five-year forecast period. The policy measures will leave a very narrow headroom at GBP8.9bn – OBR sees a 54% probability that the fiscal rule would be met; if, for example, the actual interest rate levels were 0.3 percentage point higher than their budget assumptions, this buffer would be eliminated. Meanwhile, OBR revised down its inflation forecast, now expecting Q4 inflation at 1.4% versus the 2.8% previously expected; forecasts for gas prices and oil prices have also been revised lower. While the outcome was nothing dramatic, the overall remit and the issuances of medium tenors was after all on the high side. Gilts underperformances against swaps were extended at the mid to long tenors.



Source: Bloomberg, OCBC Research

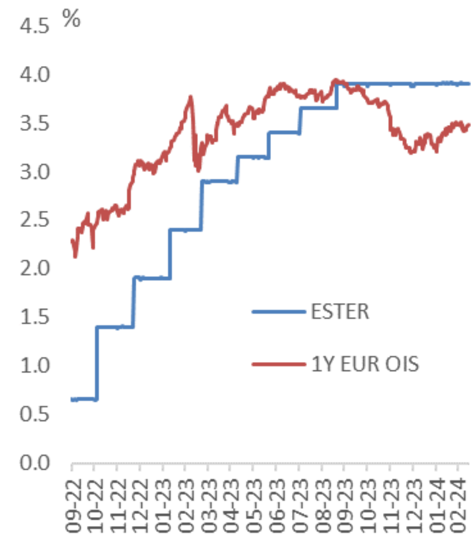
Interest rates forecasts	Q124	Q224	Q324	Q424
BoE Base Rate	5.25	5.25	4.75	4.50
GBP SONIA	5.19	5.19	4.69	4.44
3M GBP OIS SONIA	5.20	5.15	4.65	4.40

EUR:

Bunds underperformed USTs and Gilts in the downward move in yields since late February, partly as there was not as much hawkish adjustment to be unwound. EUR OIS last priced a total of 86bps of cuts this year, which is slightly more dovish than our base-case of 75bps; we do however note that risk is for the ECB

to turn more dovish should they choose to focus more on growth than on inflation. Stournaras most recently opined that "it is appropriate to do two rate cuts before the summer break".

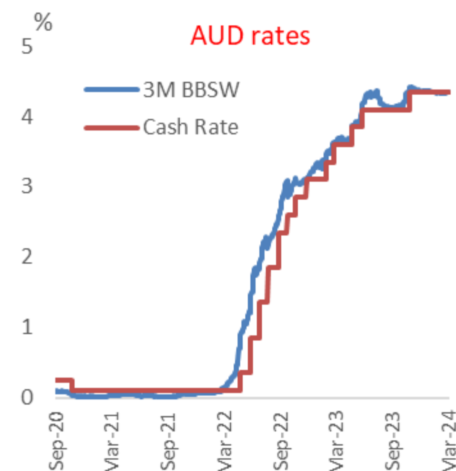
ECB kept key policy rates unchanged at its March meeting as widely expected but nevertheless **there were a couple of dovish elements**. First, the central bank revised downward its inflation forecasts, in particular for 2024 to 2.3% from 2.7%. The downward revision mainly reflects lower contribution from energy prices but forecasts for inflation excluding energy and food have also been revised lower. Lagarde in the Q&A session commented that the central bank "feel more confident about those projections". Second, while Lagarde still highlighted strong growth in wages, she added that "profits are absorbing part of the rising labour costs, which reduces the inflationary effects" – this phrase was absent in her prepared speech in January. Third, Lagarde revealed that the Governing Council did not discuss rate cuts at the March meeting, they "have just began discussing the dialling back of [their] restrictive stance". Regarding the timeline for the start of the easing cycle, Lagarde opined that the MPC "will know a little more in April, but we will know a lot more in June" to gauge if they are sufficiently confident that inflation is moving towards target. This **underlines our base-case for the first rate cut to come in June**, with the Q1 wage data out in May. EUR OIS price a 90% chance of a 25bp rate cut by the June MPC meeting which looks fair.



Source: Bloomberg, OCBC Research

AUD:

The RBA has not pivoted yet. The February MPC statement has even left the door open for further tightening, saying "a further increase in interest rates cannot be ruled out". The RBA minutes further revealed that the Board debated rate hike at the February policy meeting. The market is however not convinced that there is a material risk of additional rate hikes. Cash Rate Futures are pricing in around 45bps of rate cuts for this year. We remain of the view that the next move is likely to be a cut rather than a hike; but the RBA will probably be among the last major central banks to start the easing cycle. Current market pricing looks fair compared to our base-case for a total of 50bps of cuts this year likely starting at the August or September MPC meeting. The 1M and 3M BBSW have tended to move in tandem with OCR. Given our flat profile of the OCR in H1-2023, we expect the 1M and 3M BBSW to stay fairly stable at 4.30-4.35% over the coming months.



Source: Bloomberg, OCBC Research

Interest rates forecasts	Q124	Q224	Q324	Q424
RBA OCR	4.35	4.35	4.10	3.85
1M BBSW	4.30	4.30	4.10	3.85
3M BBSW	4.35	4.35	4.15	3.90

JPY:

It has been our long-end view that the BoJ is likely to exit NIRP as soon as this month. Recent official commentaries have largely painted a post NIRP exit and post YCC-removed scenario. Rengo – the Japanese Trade Union Confederation – said in its initial results that an average 5.28% wage hike has been won. Robust wage growth shall give the BoJ the greenlight to start normalizing monetary policy. There are a few parts of BoJ monetary policy:

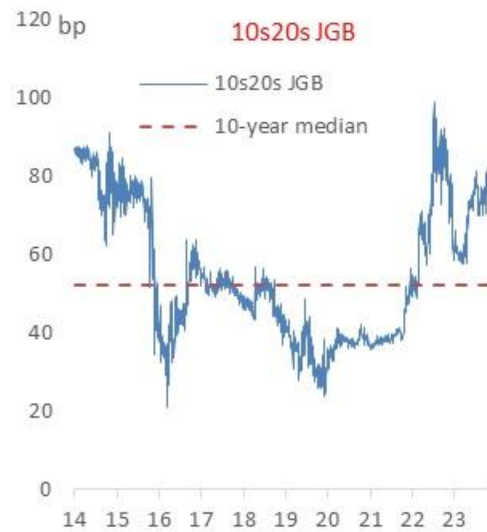
1/ Short-term interest rate. We expect a 10bp hike in the policy-rate balance rate from -10bps to zero percent. This would make the current three-rate system into a two-rate system, as a first step in normalising interest rate policy.

2/ Long-term interest rate: it is a close call as to whether the BoJ will remove the guidance of "10-year JGB yields will remain at around zero percent" at this upcoming meeting. We do however note the 1% is now a soft target after all. In other words, removing YCC at this juncture shall not be too disruptive to the market, with BoJ's intention to continue with JGB purchases.

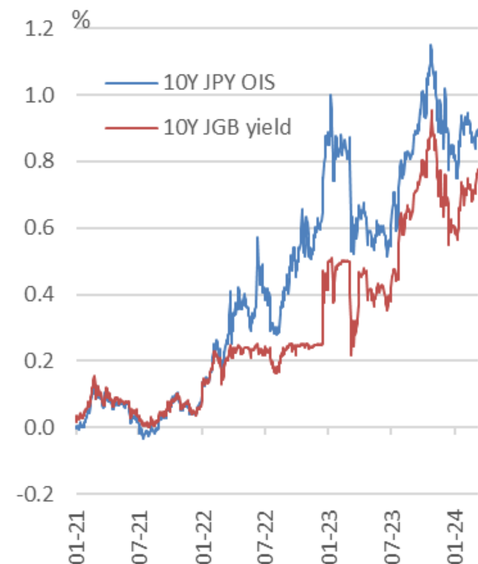
3/ Conduct of YCC: the BoJ is likely to continue with JGB purchases even if they decide to remove YCC (2/ above); this part may just need to be renamed as "JGB purchases" if there is no longer YCC.

4/ Asset purchases. The BoJ may well stop/reduce asset purchase other than JGBs.

Despite the rate hike prospect, **we have a steepening bias on the JGB curve across the 2s10s segment**, as the YCC may also be removed and even if not, market will likely contemplate the likelihood of a removal down the road, while the BoJ is unlikely to hike policy rates aggressively. If the 10Y bond/swap spread and the 10s20s yield spread were to revert to multi-year median levels, with reference to the highs in the 10Y JPY OIS and 20Y JGB yields attained in late October/early November, then the next support for the 10Y JGB sits at the 1.10-1.20% area – still some way to go from current market level.



Source: Bloomberg, OCBC Research



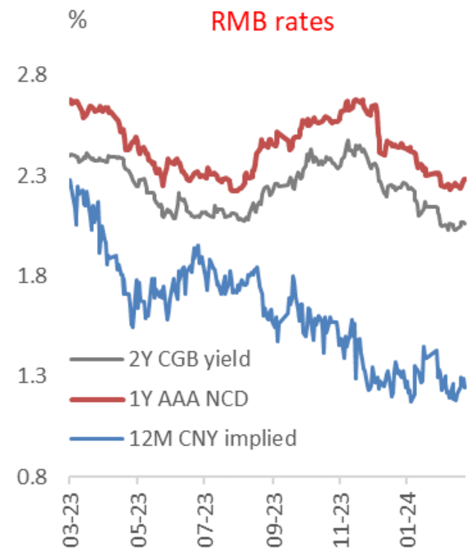
Source: Bloomberg, OCBC Research

CNY:

CGB yields had been on a steady downtrend across tenors since December on a confluence of factors, with the latest catalyst being the strong hint from PBoC Governor Pan on further monetary policy easing while market sentiment has not recovered which favours asset allocation into safe havens. We earlier cautioned against chasing long-end CGB yields lower. Yields have since rebounded; still, at current levels, we are at best neutral long-end CGBs: 1/ while there was no upside surprise to fiscal stimulus thus far, **long-end bond supply is after all on the high side**. 2/ **Reflating the economy is likely an item**

high on the policy agenda which shall set a floor to yields. As OCBC Economist pointed out, the 3% to GDP and CNY4.06trn deficit numbers imply an assumed nominal GDP growth of 7.4%, versus 4.6% in 2023. This reflects the intent to reflate the economy.

Supporting CGBs would be asset allocation needs, in addition to monetary policy easing expectation, as domestic investors avoided risk assets at the moment. From foreign investors perspective, asset swaps into onshore NCDs and CGBs continue to provide pick-up for USD-funded investors thanks to low implied RMB rates, although these pick-ups have narrowed somewhat. For example, 12M implied CNY was last at 1.24% versus 1Y AAA NCD rate at 2.28% and 1Y CGB yield at 1.83%, which provides pick-ups of around 100bps and 60bps against SOFR respectively. Do note these asset swaps do not take into account the different credit profiles.



Source: Bloomberg, OCBC Research

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