GLOBAL MARKETS RESEARCH

Daily Market Outlook
11 April 2024

Over-reaction to US CPI?

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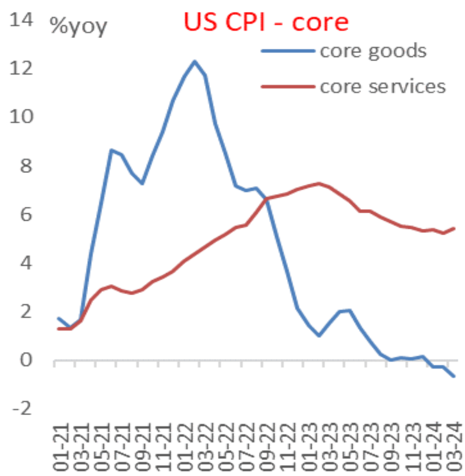
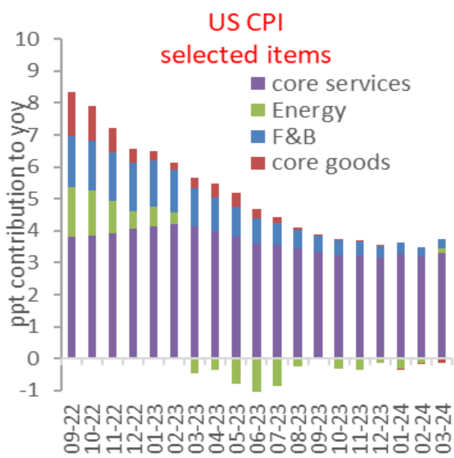
- **USD rates**. UST yield jumped on the CPI print, with the 2Y yield up by more than 20bps. Market further pared back rate cut expectations; Fed funds futures price a total of 42bps of cuts for this year, and now see the timing of the first rate cut between the July and the September FOMC meetings. There might be some overshooting in terms of bond market reaction. After recent adjustments, the near-term outlook for USTs may turn more balanced with a mild bullish bias. If sequential (MoM) inflation were to continue with the recent pace, that would limit the scope for the FOMC to deliver rate cuts, and thus pressure UST valuation. There are, however, factors which may support USTs at current levels or even suggest that the market might have overshot. First, upside risk to energy prices partly emanates from geopolitics, which shall result in safe haven flows into USTs; Second, now that with higher market rates, financial condition is getting tighter which works towards Fed's easing agenda instead of being against it when the market was running ahead of the curve at the start of the year; Third, back to CPI, the overall base effect becomes more favourable for softer YoY CPI prints in the months of April, May and June, albeit with key swing factors being energy prices. FOMC minutes showed most members largely downplayed January and February inflation data, citing strong seasonality; but given the March CPI also printed to the upside, market did not pay attention to the FOMC minutes.



Source: Bloomberg, OCBC Research

- **US CPI.** Headline CPI inflation picked up to 3.5%YoY, higher than consensus of 3.4%. The energy component contributed positively to headline YoY inflation, after being a drag for twelve months. Otherwise, core goods inflation continued to be a negative YoY contributor. Meanwhile, core services inflation re-accelerated to 5.40%YoY; indeed, since it dropped below the 5.50% market last October, core services inflation had ranged between 5.22-5.47%, reflecting its stickiness. Contribution from core services excluding rent of shelter – a key indicator that the FOMC monitors - ticked up. The overall base effect becomes more favourable for a softer CPI print in the months of April, May and June; before the June FOMC meeting, April and May CPI (same day as the June decision) will be out, which may affect market pricings again.



Source: CEIC, OCBC Research

- **DXY.** ***Supported.*** USD jumped, in response to the hotter than expected CPI report. Markets have pushed back timing of first Fed cut to Sep and reduced the quantum of rate cut for 2024 to under 50bps. We do not rule out that the reaction post-CPI shock was an overshoot and eventual correction should see USD strength ease.

Elsewhere geopolitical tensions in the Middle East may curb risk appetite to some extent. Gold and oil prices may continue to stay supported. DXY was last at 105.15 levels. Daily momentum turned mild bullish but the rise in RSI moderated. Consolidation likely. Resistance at 105.30 (recent high), 105.75 (76.4% fibo). Support at 104.80 (61.8% fibo), 104 (50% fibo retracement of Oct high to Jan low).

- **Other DM rates**. There were spillovers onto other markets from the US CPI outcome, with Gilt yields and Bund yields going higher. This morning, ACGBs and JGBs opened weaker in Asia. We believe the BoJ will mostly allow market forces to push up the **10Y JGB yield**; we continue to see the 1.1-1.2% level as the next support for the 10Y bond. **ECB** is widely expected to keep policy rates unchanged later today. Since the March MPC meeting, the consensus among MPC members appear to be growing for a June rate cut. Q1 employment report to be out in mid-May shall be the last bit of evidence for the central bank to gain enough confidence to start cutting rates. We suspect the central bank will provide little clue as to how the policy rate will go after the first rate cut is delivered, as Lagarde commented that the committee cannot pre-commit to a particular path and instead shall have an open mind. Our base-case assumption is rate cuts will be paced out. EUR OIS price the chance of a 25bps cut by the June MPC meeting at an 87% chance and price a total of 75bps of cuts for this year, in line with our base-case for 75bps of cuts. There appears to us no major dislocation in the distribution of expected cuts being priced either. We are neutral front-end EUR rates here.

- **EURUSD. *ECB Today.*** EUR fell sharply as USD surged post-CPI. Pair was last at 1.0860 levels. Daily momentum shows signs of turning mild bullish while RSI rose. Risks skewed to the upside. Resistance at 1.0876 (38.2% fibo retracement of Oct low to Jan high), 1.0930 levels. Support at 1.0830 (50, 200 DMAs), 1.0795 (50% fibo). Policy decision at 815pm followed by press conference at 845pm. We will focus on the latter. We expect ECB to acknowledge that inflation is returning to 2% objective but sticky services inflation at 4% and the near-term repercussion of higher oil prices may well see ECB push back on easing expectations. I think there is quite a fair bit of dovish hold bias going into ECB, and lately, German numbers have been showing up pretty well, including ZEW survey, IFO expectations and even industrial production. EUR bears might be caught backfooted if ECB turns out to be less dovish than expected.

- **USDAXJs. *Bid.*** USDAXJs broadly traded higher, following the surprise bump up in US CPI (yesterday), which resurrected the narrative that high rates may well be the case for longer. Downside surprise to China CPI (this morning) reignited worries that deflation risks in China remain real. Given higher UST yields and softer RMB, THB, KRW and TWD were the top underperformers. On RMB fix this morning, The strong fix at 7.0968 (below 7.10) simply underscores policymakers' desire and will to pursue RMB stability. Clearly, the fix is outside of Bloomberg consensus estimates (7.1040 – 7.2641) and the strong fix shows that policymakers want to send a strong message to markets. Intervention may pick up in the region if there is excessive one-way move on AXJ FX. But intervention cannot reverse a trend, it can (at best) smooth volatility or slow the pace of depreciation - in a way buying time. With most AXJs, including TWD, THB, KRW at their respectively lows (vs. USD) for the year, we may expect to see authorities smoothing volatility at key levels. For USDKRW, USDTWD and USDTHB, we see resistance coming in at 1165, 32.28 and 37.10, respectively.

- **USDSGD. *MAS Policy Decision on Tap Tomorrow (8am).*** We expect MAS to maintain policy status quo again at the upcoming MPC meeting in Apr as prevailing appreciating path of the S$NEER policy band remains appropriate, given the core CPI profile. Re-acceleration in Singapore CPI reflected the effects of Lunar New Year and was well within the guidance of policymakers that core CPI is expected to rise in current quarter. This should dampen market chatters that a potential MAS easing is round the corner. History shows that MAS did not rush into easing after inflation peaked at previous cycles in 2010s. Instead, the MAS maintained its appreciating policy stance on hold for a while. USDSGD rose, in line with most USD/AXJs after US CPI surprised to the upside. The data triggered hawkish repricing as markets now see less than 2 Fed cuts for the year. Even the timing of first cut has been pushed out to Sep. Pair was last at 1.3530 levels. Bullish momentum on daily chart intact while rise in RSI moderated. We look for some consolidation after the recent run-up. Resistance here at 1.3530/45 (61.8% fibo, interim double top, recent high). Support at 1.3460/70 levels (200 DMA, 50% fibo), 1.3430 (50 DMA) and 1.3390/1.34 (38.2% fibo retracement of Oct high to Dec low, 21, 100 DMAs). S$NEER held steady; last at +1.69% above our model-implied mid.

- **SGD rates**. SGD OIS were paid up by 8-15bps this morning in a steepening manner, outperforming USD rates especially at the front-end. The 1Y and 2Y SGD-USD OIS spreads turned more negative, and last traded at -170bps and -144bps respectively. As we commented, *in either a rising or a falling rates environment, SGD rates are likely to be relatively more stable than USD rates*. Today brings the auction of SGD6.3bn of 6M T-bills; 6M SGD implied rate was trading at around 3.61% this morning, similar to the level at the last auction day. Meanwhile, SGD liquidity has improved somewhat. On balance, the T-bill cut-off may come in mildly lower than the last cut-off of 3.80%. We expect MAS to keep its SGD NEER parameters unchanged tomorrow; hence, there shall be minimal implication on front-end SGD rates.

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