

Fundamental Highlights

Balancing FOMC rate hike anticipation and yield hunt.

A gentle and calm repricing of FOMC rate hike expectations appear to be underway in the financial markets. Fortunately, there is no sign of the taper tantrum or December blues associated with the initial 2015 liftoff. Even then, May 2016 marked the worst monthly sell-off since December (when the Fed embarked on its first 25bp rate hike) for the 2-year UST bond, which is traditionally the most sensitive to Fed expectations. This was attributable to the hawkish tone in the April FOMC minutes and Fed speakers also played up the prospect of the next 25bp rate hike in summer. Whilst the futures probability for a hike at the 15 June FOMC remains subdued +/-30%, it rises to above 50% for the 27 July FOMC. Will Yellen walk her talk? Be careful of a potential replay of December 2015 when Yellen succeeded in assuaging the pain of a rate hike by talking very dovishly – if so, then a sell the rumour, buy the fact could materialise again for bonds (conversely for the USD). Elsewhere, the Brexit polls continue to sway but without disastrous effects on the UK or the broader Eurozone markets for now. Market focus remains on China with a L-shaped recovery shadowing investors' minds, especially with potential Fed hike. Whether the OPEC meeting this week can reach an agreement will also imply if crude oil prices can finally surmount the US\$50 per barrel handle in 2H16. Stay tuned for now.

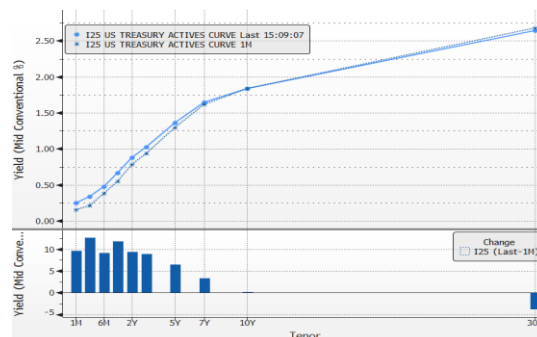
SGS Review and Outlook

Summertime blues: FOMC, China & Brexit risks intact

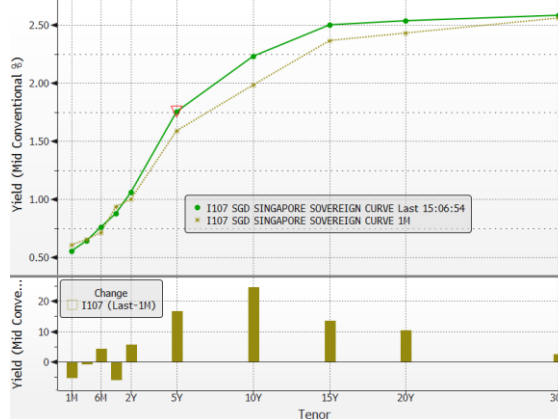
The S'pore economy expanded by a revised 0.2% qoq saar (+1.8% yoy), with manufacturing a tad better than initially estimated but the key services sectors registering a faster deceleration. While there was no change to the official 1-3% growth or headline/core inflation forecasts, the 2016 NODX forecast was trimmed from 0-2% to -3% to -5%. Looking ahead, potential FOMC policy normalization, China's uneven restructuring and Brexit risks remain on the radar screen, contributing to downside growth risks still. We tip that 2Q16 GDP growth could dip by 1% qoq saar. In terms of policy direction, fiscal and monetary policy options remain open and data-dependent. The S\$NEER is unlikely to steer a solitary course against the overall receding tide within Asia. A re-centering lower for the S\$NEER band at a future stage (possibly at October MPS?) could be potentially perceived as a gradual recalibration if a further downshift in overall growth and inflation expectations materialises.

As we anticipated, May turned out to be a choppy month and June may not be very different. The SGS yield curve steepened in May, led by the longer-tenors due to the \$2.5b new 10-year SGS bond market auction. The 10-year SGS auction fetched a bid-cover ratio of 1.71x with a cut-off yield of 2.15% and a tail of 5bps. Next up is a 2-year SGS bond re-opening on 1 July, followed by a new 20-year SGS bond on 1 August, where we could see pressure on the longer-dated bonds re-emerging again. The selling pressure on the front-end of the yield curve should stay modest due to the relatively stable anchoring of the short-term domestic interest rates.

US Treasury bond yield curve flattened amid hawkish Fed rhetoric in May



SGS bond yield steepened with 10-year auction



OCBC Bank

For research enquiries, please email Lingsssnelena@ocbc.com.sg

Group Treasury

Treasury Research & Strategy

Selena Ling **(65) 6530 4887**

Fixed Income Sales

Lee Siu Gim **(65) 6349 1810**

SGS Trading

Pan Tan **(65) 6530 4723**

Indicative SGS prices as at 31 May 2016

Issue	Maturity	Coupon	Bid Price	Ask Price	Bid Yield (%)	Ask Yield (%)
NY01100F	3.75%	Sep-16	100.76	100.8	0.70%	0.54%
N710100Z	2.38%	Apr-17	101.28	101.32	0.83%	0.78%
N215100F	1.38%	Oct-17	100.58	100.62	0.94%	0.91%
N513100T	0.50%	Apr-18	98.94	99.02	1.09%	1.04%
NY03100A	4.00%	Sep-18	106.42	106.52	1.10%	1.06%
NX09100W	2.50%	Jun-19	103.57	103.67	1.28%	1.25%
N514100H	1.63%	Oct-19	100.96	101.06	1.33%	1.30%
N515100S	2.00%	Jul-20	101.95	102.05	1.51%	1.48%
NY05100N	3.25%	Sep-20	106.96	107.06	1.55%	1.53%
NX11100X	2.25%	Jun-21	102.19	102.39	1.79%	1.75%
NY07100X	3.13%	Sep-22	106.84	107.04	1.96%	1.92%
NX13100H	2.75%	Jul-23	104.39	104.59	2.08%	2.05%
NY09100H	3.00%	Sep-24	106.25	106.45	2.17%	2.14%
NX15100Z	2.38%	Jun-25	101.27	101.47	2.22%	2.19%
NZ07100S	3.50%	Mar-27	110.99	111.29	2.34%	2.31%
NY14100E	2.88%	Jul-29	104.71	105.01	2.45%	2.43%
NZ10100F	2.88%	Sep-30	104.34	104.64	2.51%	2.49%
NZ13100V	3.38%	Sep-33	111.39	111.79	2.55%	2.53%
NA12100N	2.75%	Apr-42	103.39	103.99	2.57%	2.54%

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