1H2023 FX and Rates Outlook

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Treasury Research & Strategy
Global Treasury

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Key Macro Themes and Strategy

Policy backdrop: Fed funds rate (upper end) to peak at 5.00%; QT continues at Fed and BoE, may start at ECB; potential policy pivot at BoJ

Growth: A synchronized economic downturn in 2023 is expected in major economies; nevertheless, pause by major central banks will provide some relief for both the financial markets and the real economy.

	Rates Strategy	FX Strategy
Fed Policy Calibration	▪ 2Y UST yield to peak below peak policy rate ▪ Curves to steepen: UST, SGS, MGS	▪ Slowing Fed-BoJ policy divergence favors short USDJPY ▪ Long Gold
China Reopening/ Policy Support Measures	▪ CNY rates have bottomed ▪ Buy back-end CNH points on dips	▪ Supports RMB gains. Commodity-linked FX (AUD), tourism-linked FX (THB), trade-linked (MYR), risk-proxy FX (KRW) should outperform
Relative Value Trades	▪ Gilts to underperform GBP OIS and USTs ▪ Potential inflows into KTBs, IndoGBs, CGBs ▪ Asia LCY bond outperformance not extended ▪ SGD-USD rate spreads to turn less negative	▪ Short S$ selectively vs oversold Asian FX including JPY, AUD, KRW and THB given moderate-to-soft USD profile and fading risk aversion

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Summary of rates market views:

Policy backdrop:

- Our Fed rate hike profile is 50bp-50bp in December and Q1 respectively, which will bring the Fed funds target rate to 5.00% (upper end); expect no easing from the Fed throughout 2023. Risk of earlier easing should the Fed push rate higher than what we expect.
- QT continues at the Fed and the BoE; may start at the ECB. Potential policy pivot at the BoJ.

Markets:

- **Trade calibration and peak rates:** We expect peak rates will come in Q1/Q2-2023 for most markets. As we enter the late stage of the hiking cycle, market will be reluctant to bring itself too much ahead of the policy curve. Expect 2Y UST yield to peak at 4.60%, somewhere below our expected peak effective Fed funds rate.
- **Curve steepening**. We have a steepening bias across markets, including 2s10s UST, 2s10s SGS, and 3s10s MGS.
- Expect **Gilts to underperform GBP OIS; Gilts to underperform USTs.** Gilt supply stays slightly on the high side through next fiscal year, while BoE QT is ongoing and BoE have to offload those Gilts and linkers they purchased under its temporary program.
- **Asian rates – no more across-the-board outperformance; focus on relative value**: Yield differentials have been much compressed. As UST yields stabilize, outperformance in Asian LCY bonds is unlikely to be extended. Some Asian central banks may need to hike rates further, leading to upward adjustment in yields. KTBs stand to benefit from inflows; inflows into CGBs and IndoGBs may come back on a more sustained basis if the domestic yields can adjust higher during the early part of 2023, given already reduced foreign holdings.

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Summary of rates market views:

Markets:

- **IDR**: mild upside to IndoGB yields which will render the domestic bonds more appealing to foreign investors. Foreign holding positions are light which is an added positive for potential bond inflows. The domestic supply outlook is constructive for IndoGBs.
- **MYR**: the 3Y MGS shall stay relatively resilient on the curve, as the 3Y yield is already ahead of the policy curve; 3s10s part to steepen on current flatness of the curve, likely anchored front-end yield, and mild supply risk.
- **SGD**: Small window of opportunity for further outperformance in 10Y SGS over UST for the rest of this year/early 2023, as issuance of long tenor SGS is back-loaded. Other than this, bias is for SGD-USD rates spreads to widen (less negative) mildly and the curve to steepen.
- **KRW**. BoK is near the end of hiking cycle. Potential bond inflows can be significant if bond index inclusion is confirmed. Real yield differentials are supportive, while basis shall remain anchored allowing for asset swap trade.
- **CNY / CNH**: lows in CNY rates and yields have probably been seen upon more economic supportive measures while the monetary policy stance has become balanced (from an easing bias). Bond inflows to come back after some further upward adjustment in CGB yields, as passive asset allocations are yet to be deployed.

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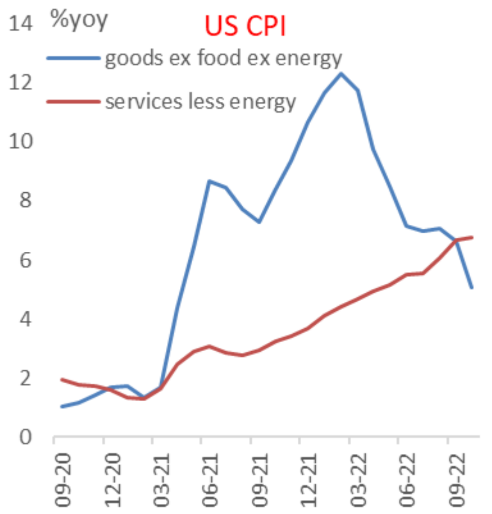
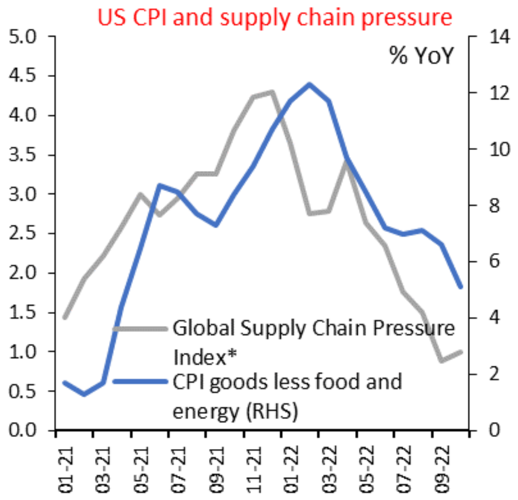
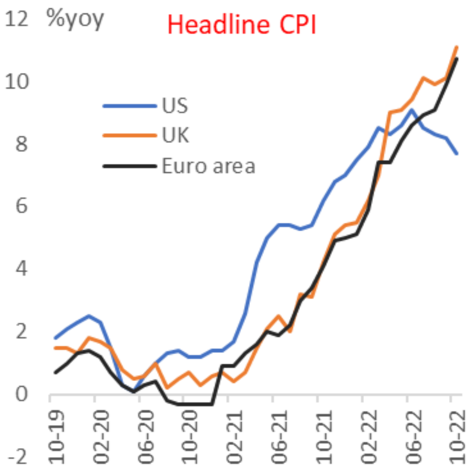
DM rates

US: peaking inflation

- US core CPI decelerated more than expected in October. The highlight shall be on core goods price inflation, which has been slowing steadily from a peak of 12.3% YoY to the latest 5.1% YoY, reflecting easing supply chain disruptions.
- Granted, inflation is still high compared to recent history and Fed target, but signs of softening are good enough for the market **to trade on the peaking inflation and policy calibration narrative.**







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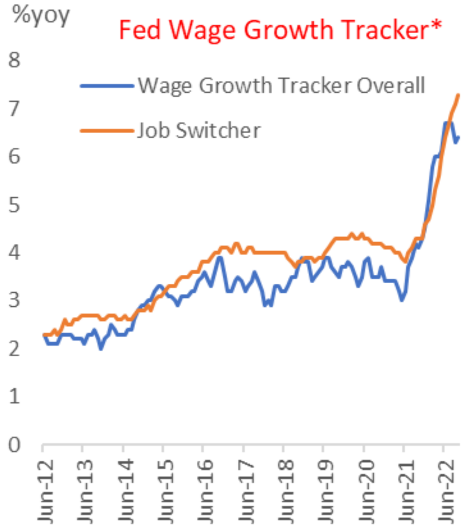
Source: Bloomberg, Bloomberg, CEIC, OCBC
* NY Fed's Global Supply Chain Pressure Index; index represents number of standard deviation away from average

Tight labour market; sticky wage

- That said, wage growth is still robust. The Atlanta Fed's Wage Growth Tracker showed overall wage growth at a still high 6.4% YoY (latest); wage growth for job switchers was higher at 6.7% YoY pointing to persistent pressure. Wage tends to be sticky downward, especially with still elevated job vacancies – elevated across major markets.
- Inflation being sticky downward supports our **base-case for no Fed easing in 2023**.



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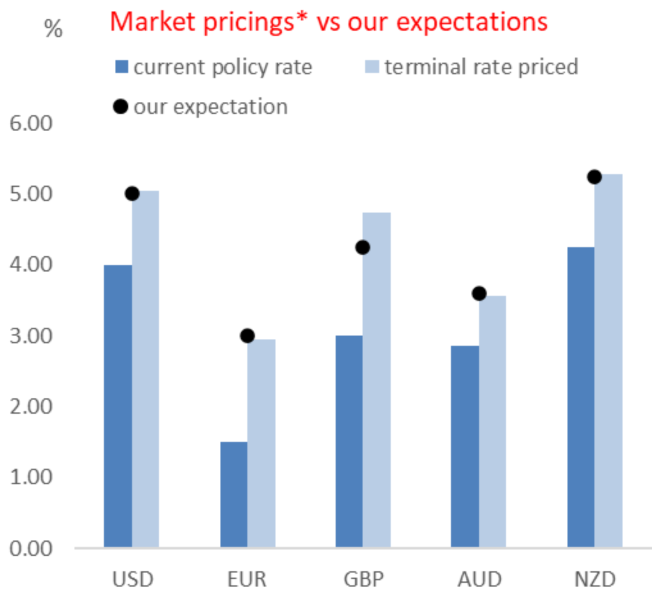
Source: Bloomberg, OCBC
* Federal Reserve Bank of Atlanta's Wage Growth Tracker: a measure of nominal wage growth reflecting the median % change in the hourly wage of individuals

Market pricings of terminal rates

- Pricing of terminal rates in most major markets we cover looks fair to us. We would **expect market pricings of terminal rates to behave in a more stable manner** than during most part of 2022, as the economies enter the late stage of the hiking cycle.

- GBP OIS pricing looks slightly overly hawkish – but the pricing may have incorporated some paying hedges as well; as such, outright receive positions are not preferred.



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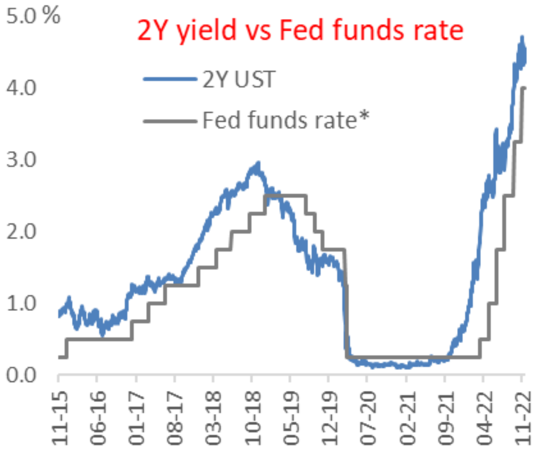
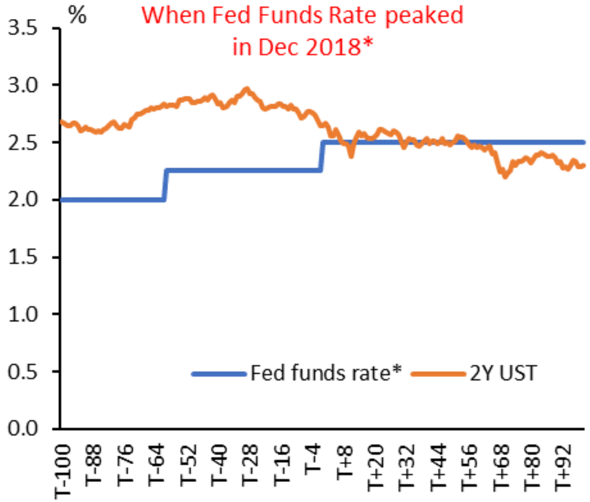
Source: Bloomberg, OCBC
*05 December 2022

Short-end USTs – trade calibration

- We compare 2Y UST yield with Fed funds target rate. At the previous cycle, the 2Y yield overshot peak Fed funds rate before edging lower around two months after Fed Funds rate peaked; the initial downward move was not significant. The downward move was only established starting from four months after Fed Funds Rate peaked, or three months before the start of the easing cycle.
- For the current cycle, we expect the 2Y yield to undershoot peak rate mildly as the growth outlook is more subdued than in a usual hiking cycle, and market appears happy to price in some easing. As we expect the 2Y yield to undershoot, there is limited downside room to the yield after policy rate peaks.
- We **expect the 2Y UST yield to peak somewhere below our expected peak effective Fed funds rate** – at around 4.60%. Beyond that, if the peak Fed funds rate turned out to be yet higher, that would point to a higher chance of easing some time in 2023, offsetting the higher peak rate. As such, the impact on our 2Y yield forecast shall not be material.





Source: Bloomberg, OCBC
*upper end; T + no. of weekdays

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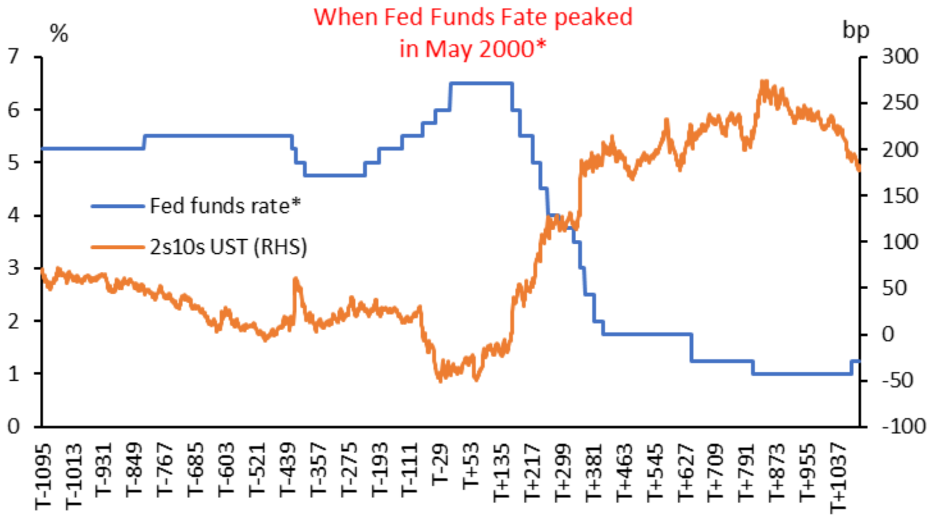
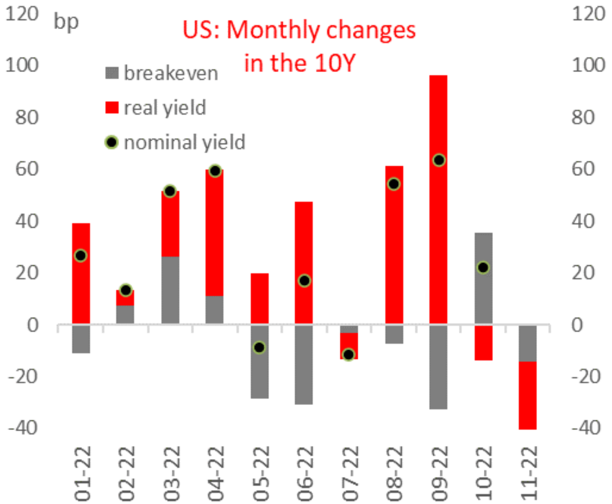
10Y UST – curve normalization

- Breakeven has fallen a lot from peak, while the 10 real yield is no longer at an elevated level; we see a mild upside bias to both components of the 10Y nominal yield.
- We expect the yield curve **to become less inverted across the 2s10s segment** as a normalization process. The timing and tendency of curve steepening after the peaking of Fed funds rate differed across previous cycles; at the 1999/2000 cycle, the 2s10s segment bottomed out three months after the Fed funds rate peak; at the 2004/06 cycle, it took five months.





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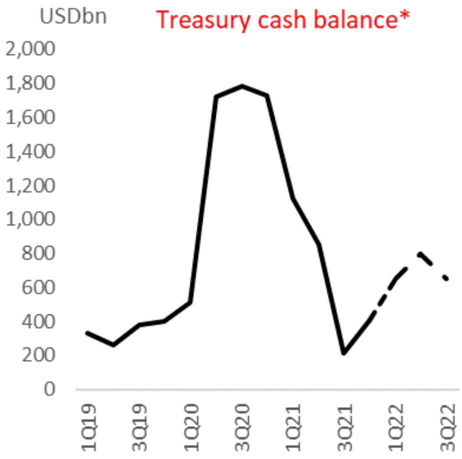
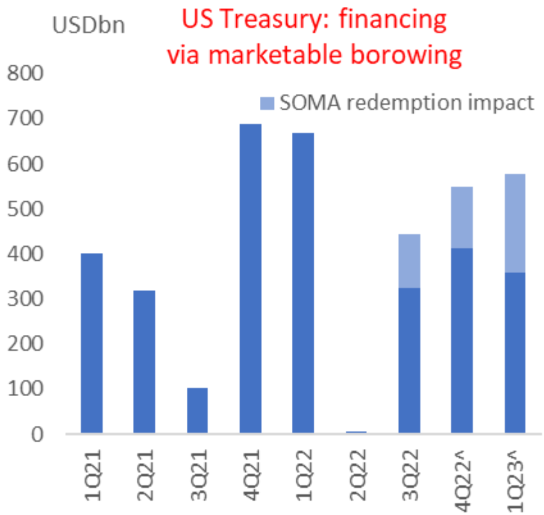
Source: Bloomberg, OCBC
*upper end; T+ no. of weekdays

UST supply

- **Supply looks manageable**. Q4/Q1 Treasury securities supply is forecasted at USD550bn and USD578bn respectively by the US Treasury, which has already incorporated the QT impact of USD139bn and USD221bn respectively.
- Cash balance is expected to be built up to serve as a buffer. The TGB balance (Treasury's cash balance at the Fed) is forecasted at USD700bn by end-Q4, which will then fall to USD500bn – helping to mitigate Q1 supply in line with our expectation. The TGA balance however has been falling recently upon paydown of bills as current debt level approaches the debt ceiling. While the cash buffer will then get thinner than planned in the interim period, this is also reflected as lower than planned issuances this quarter.

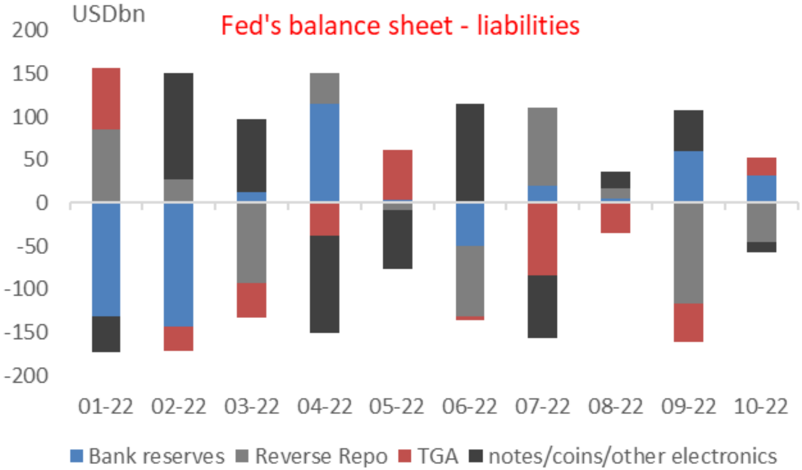


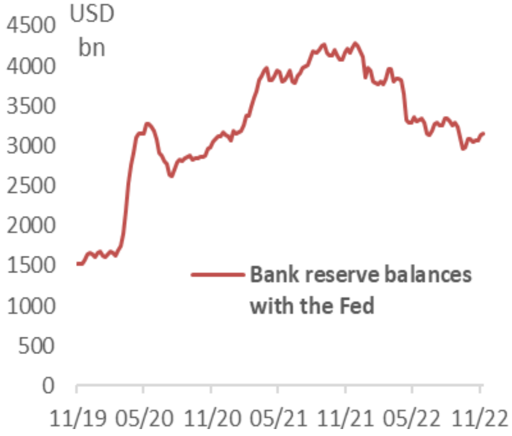


Source: US Treasury, Fed, OCBC
^US Treasury's estimates for marketable borrowing
*targeted cash balance by US Treasury for Q422 through Q323

Fed balance sheet – liability side

- The lowered usage at the Fed's reverse repo, and recently the drawdown of US Treasury's cash balance (TGA balance), have helped eased liquidity, allowing bank reserves to go up despite the shrinking Fed balance sheet.
- The **liquidity impact of QT will be felt more in 2023** as balance sheet reduction continues, and on the assumption that the debt ceiling will be resolved as it had been therefore TGA balance will be built up again.

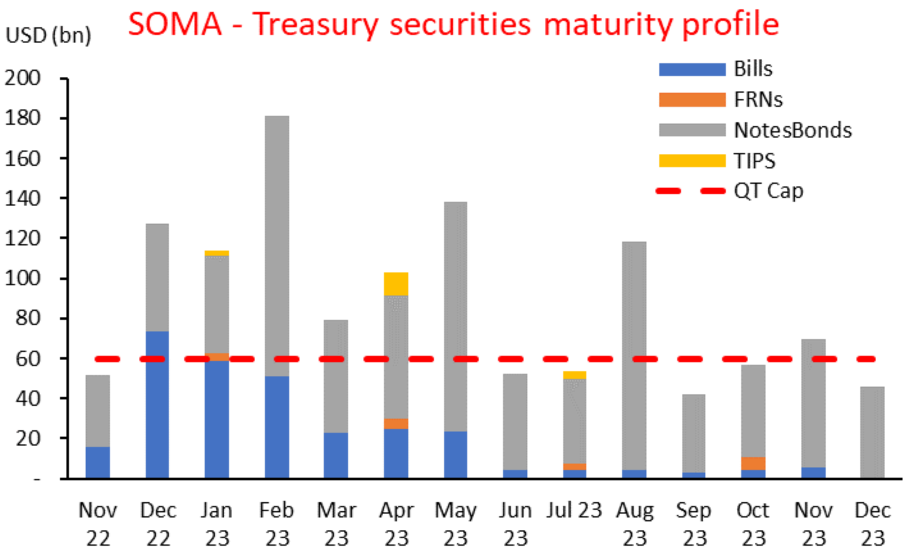




Source: Bloomberg, OCBC

Fed balance sheet – asset side

- **Quantitative Tightening**: the caps for reductions in SOMA holdings are at USD720bn via Treasury securities in 2023, and USD420bn via agency debt and agency MBS. The cap for Treasury securities will be hit for most of the months; the Fed may consider actively selling some agency debt and agency MBS as maturity may mostly not hit the monthly cap. Overall, we **expect QT totaling around USD1trn.**



Source: NY Fed, OCBC

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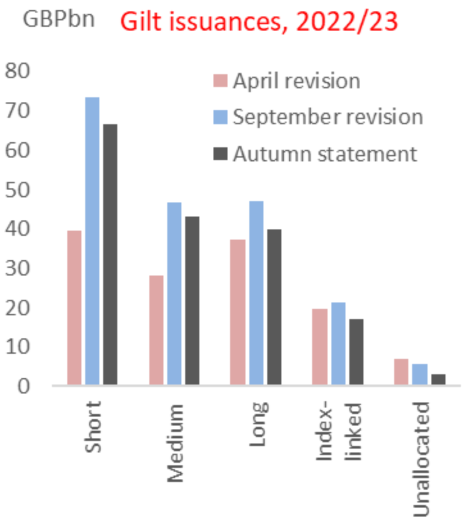
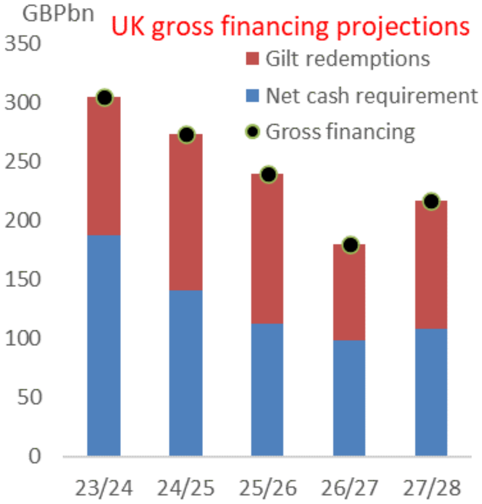
Gilt supply

- **Fiscal consolidation is back-loaded** and Gilt supply is mildly on the high side through next fiscal year; Gilt sales are planned at a total of GBP169.5bn for fiscal 2022/23, a reduction of GBP24.4bn from the September revision; but higher than April revision.
- Additional supply remains at the short tenor (3-7Y segment); nevertheless, BoE APF Gilt sales (QT) suggest demand is also relatively better at the short tenors.

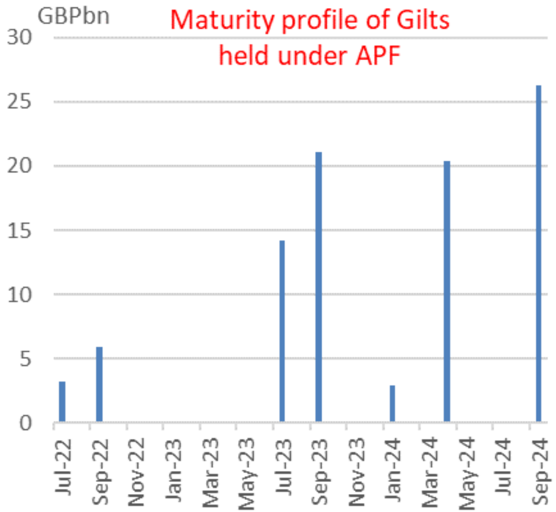




Source: UK DMO, OCBC

BoE QT

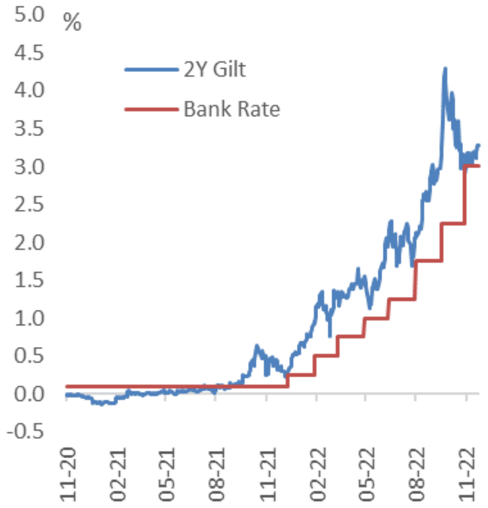
- Passive QT: the maturity profile of Gilts held under APF is disperse, with two tranches in July and September next year, totaling GBP35.3bn.
- **APF** (Asset Purchase Facility) **Gilt sales** (active QT): Active Gilt sales at GBP45bn in a 12-month period is needed to reach the annual target of balance sheet reduction of GBP80bn; weekly sales probably need to be slightly higher than the current GBP750mn.
- On top of QT, BoE still have to offload the Gilts and linkers it purchased (amounting to GBP19bn) under its temporary program.

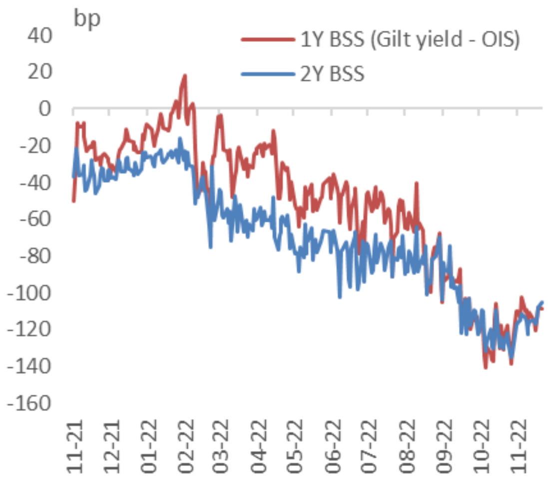


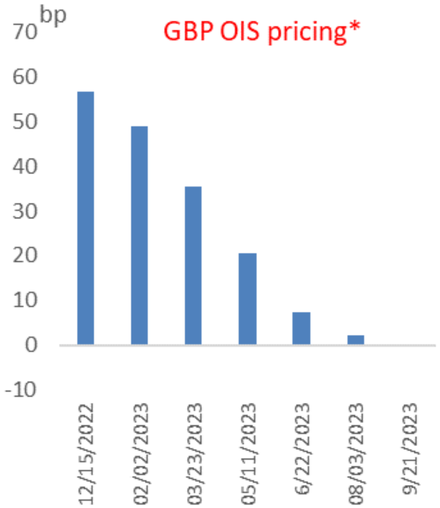
Source: UK DMO, OCBC

GBP rates

- GBP OIS pricing of terminal rate of 4.70% looks a bit overly hawkish to our expectation for peak Bank Rate at 4.25%. Meanwhile, front-end Gilts appears to be behind the policy curve.
- We **expect Gilts to underperform OIS**, on supply and BoE QT



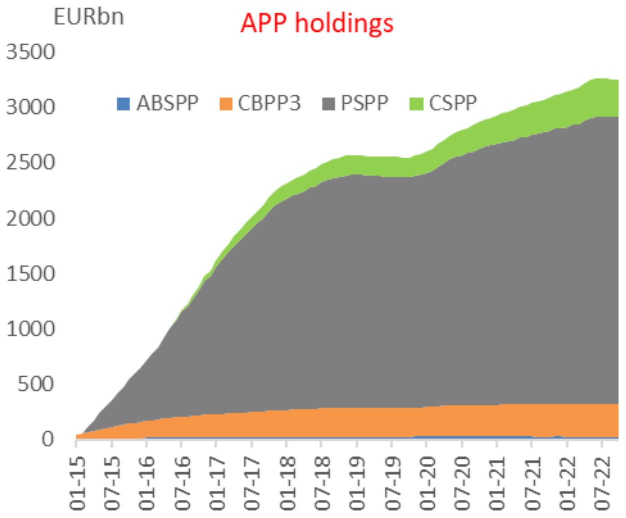


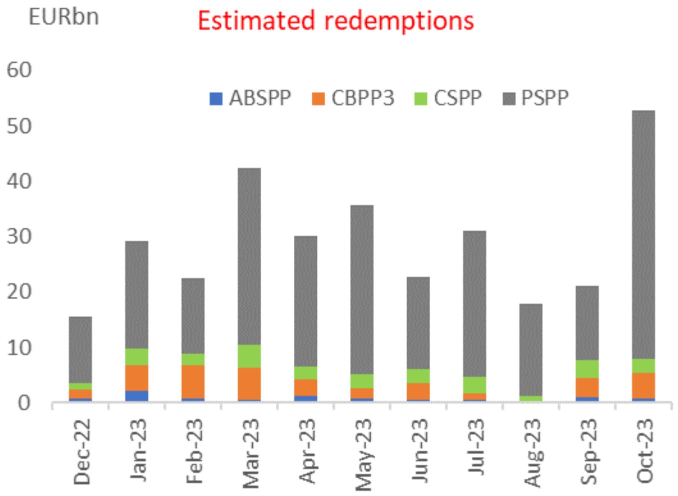


Source: Bloomberg, OCBC
*28 November 2022

ECB: rate hikes and potential QT

- We expect the ECB to hike its policy rate up to 3.00% by end Q2 2023.
- If QT is to start in Q2 2023, then the potential amount through redemptions is estimated at EUR200bn plus for 2023; but we expect there will be monthly caps which are binding. Our base-case does not include active sales of APP holdings, or QT via PEPP.



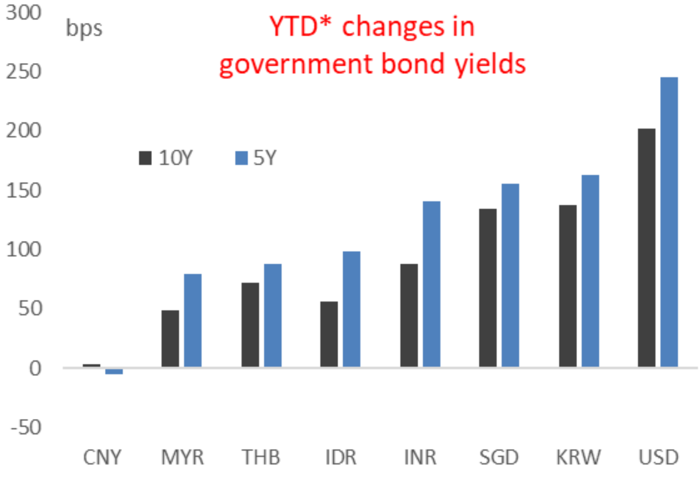


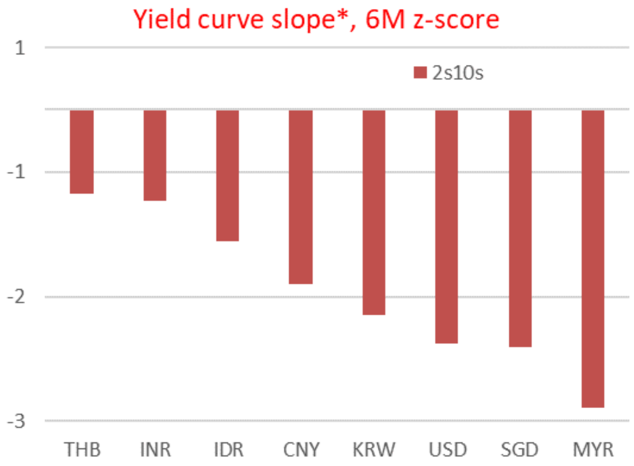
Source: ECB, Bloomberg, OCBC

Asian rates

Asia rates outperformances unlikely to be extended

- With wide yield differentials over USTs at the beginning of the year, most LCY government bonds in Asia have outperformed USTs this year, in line with one of our main themes at the start of the year. Curves have generally flattened but to a lesser extent than the UST curve did.
- We **do not expect such outperformance to continue in 2023, as UST yields likely stabilize.**





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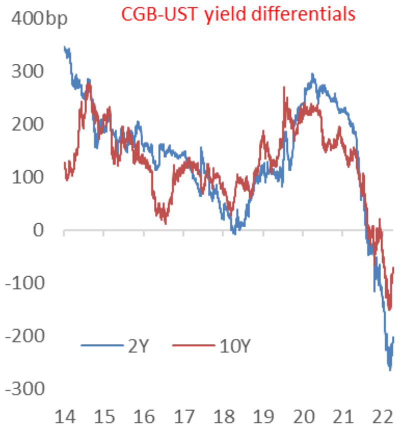
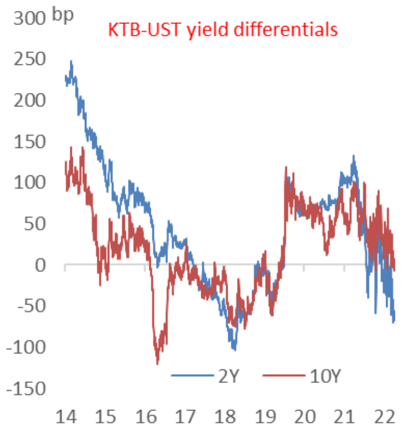
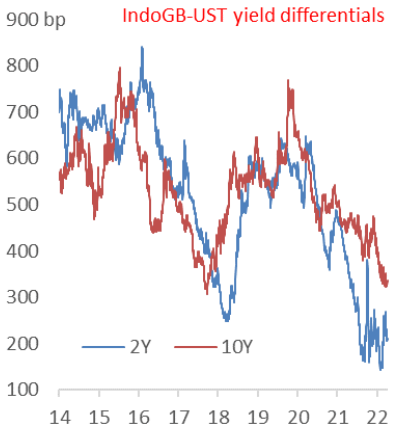
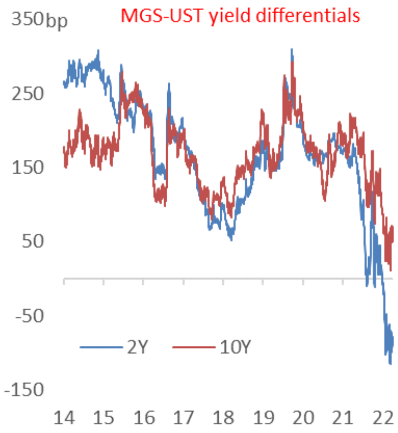
Source: Bloomberg, OCBC
*05 December 2022

Nominal yield differentials have been compressed









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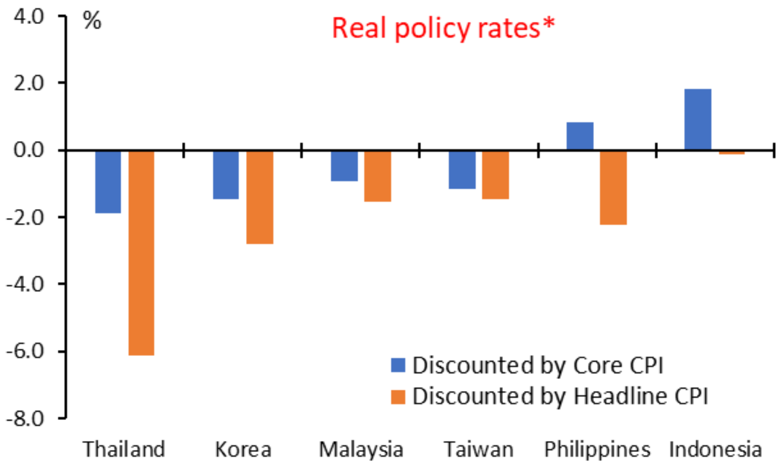
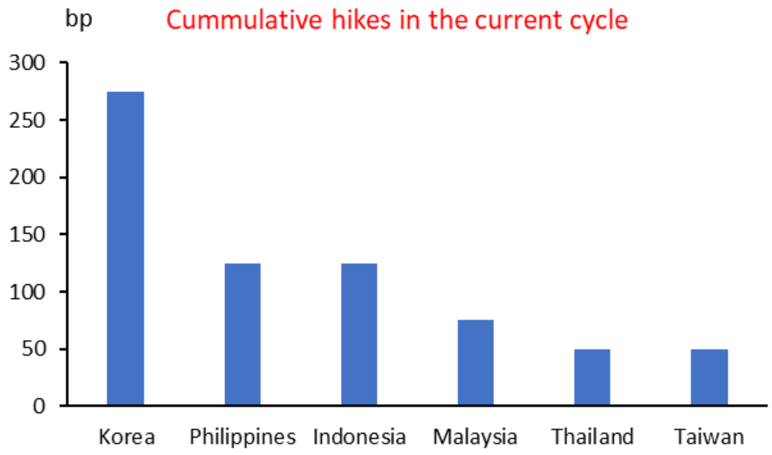
Source: Bloomberg, OCBC

Asia: real policy rates

- The tightening agenda diverges across Asian central banks; most of them have managed to refrain from hiking rates aggressively, thanks to less elevated inflation and the fact that they had not eased as much as major central banks. That said, there is **pressure for some to hike rates further** such as the Bank of Thailand on inflation consideration, and BSP and potentially BI on FX consideration. This may lead to some upward adjustment in the domestic yields, likely happening in early 2023.





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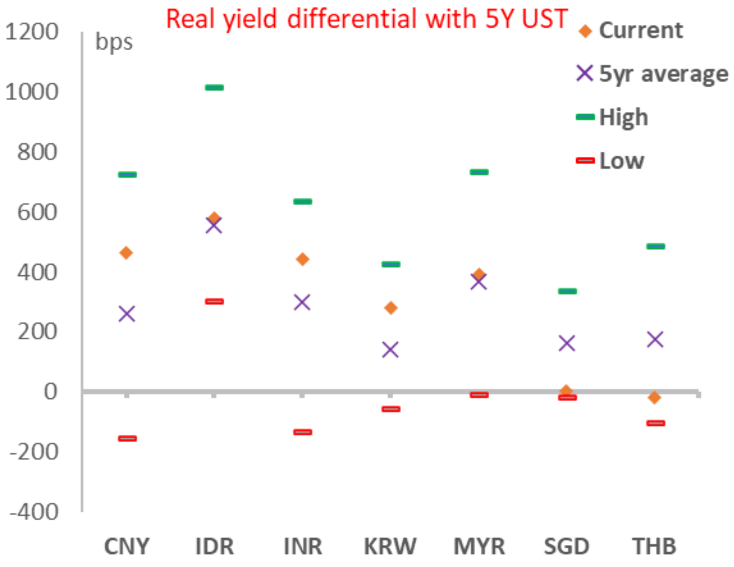
Source: Bloomberg, OCBC
*discounted by 6-month average of yoy CPI inflation.

Asia: real yield differentials

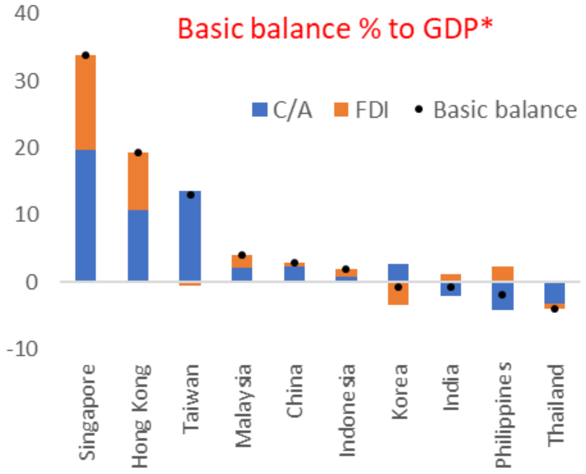
- Real yield differentials over USTs for most local currency Asian markets have been compressed, but to various extent. The differentials are still around or a tad above 5-year average for most markets; exceptions are ThaiGBs where real yield differential narrowed further after having fallen below 5-year average; and SGS where real yield differential is near the lower end of the 5-year range.
- **When global yields stabilize** – we expect peak rates will come in Q1-2023 for most markets, and Q2 for others – **investors may put more weight on real yield differentials in search for relative value**.
- That said, the high uncertainty on the inflation outlook means real yield differentials themselves can be unstable.

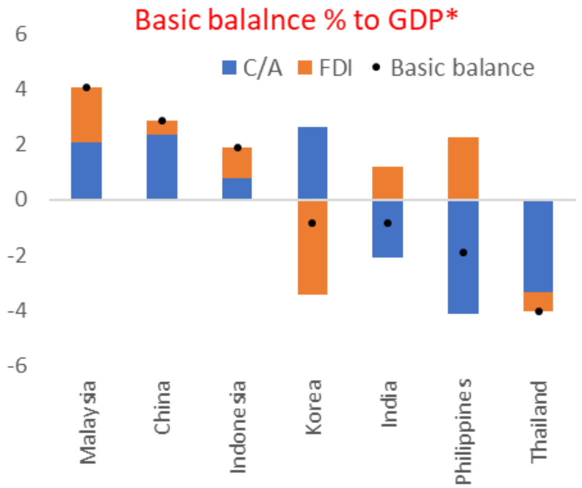


Source: Bloomberg, OCBC
As of 02 December 2022

Asia: external balances

- Current account and FDI performance varied across individual Asian economies. Most of the economies have maintained a basic balance (C/A + FDI) surplus, while the deficit for Korea appears manageable and prospect is for an improvement for Thailand.





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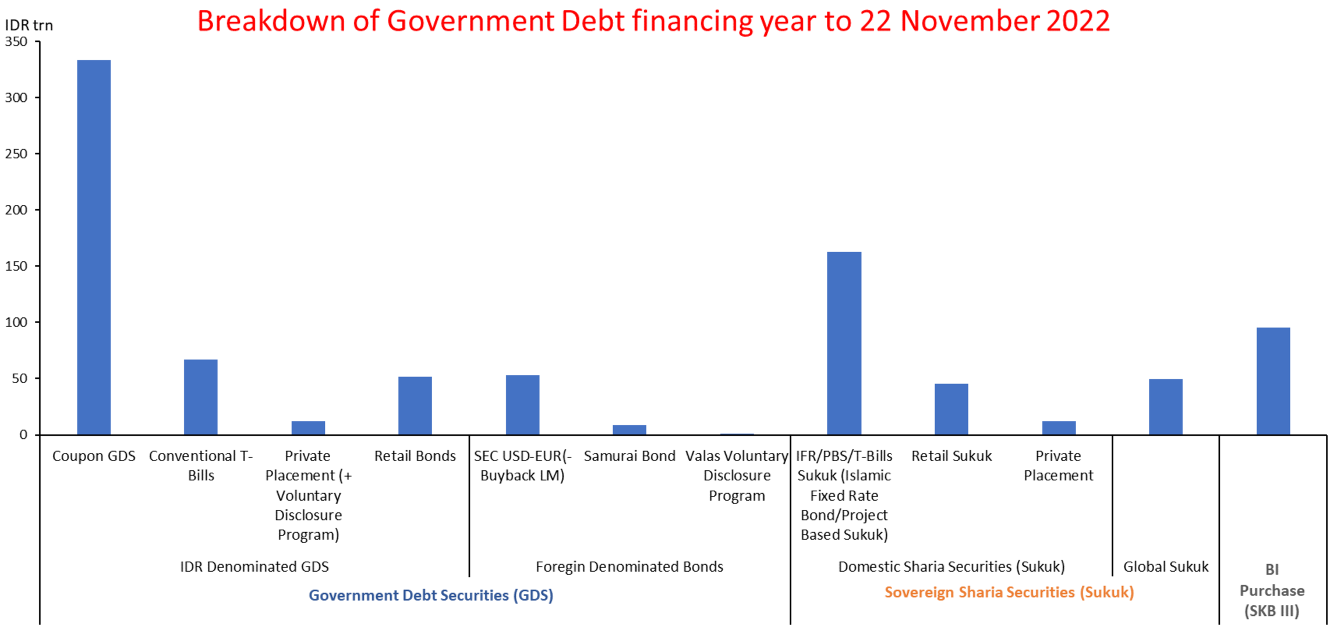
Source: CEIC, OCBC
*Q32022 or latest; omitting some economies from the right chart for the scale

IDR: Debt financing

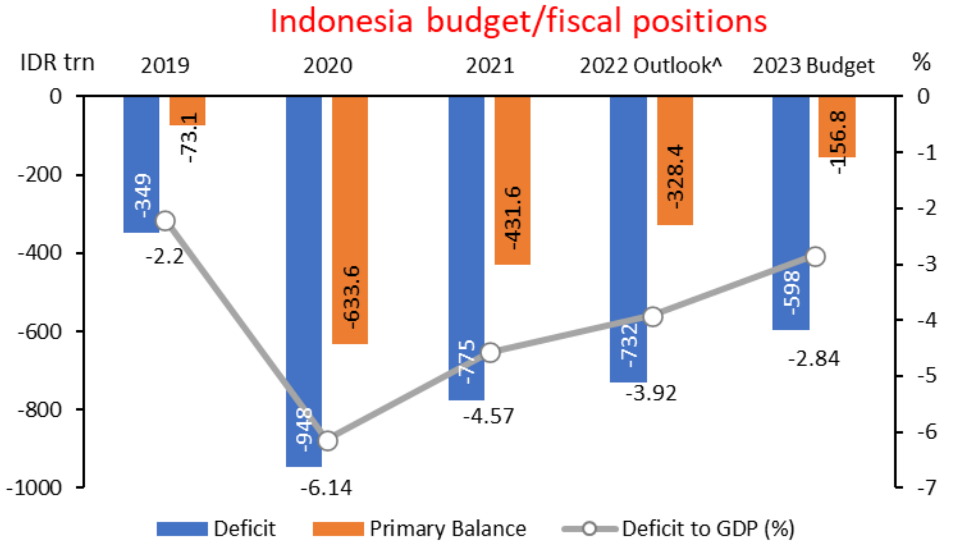
- MoF has raised IDR892trn of funds as of 22 November this year, from various channels including domestic auctions, global bonds, BI purchase (under SKB III), retail tranches and other private placement.
- As of October, fiscal revenue reached 96.3% of the revised budget, while MoF managed to spend 75.7% of the revised budget, leaving a surplus financing of IDR439.9trn.



Source: DJPPR, OCBC

IDR: 2023 budget

- The **fiscal outlook looks constructive for IndoGBs**. 2023 budget deficit is planned at IDR598trn, or 2.84% of GDP. The surplus financing can be used as a buffer for 2023, which may cover part of the financing needs should the market condition turn unfavourable for bond sales.



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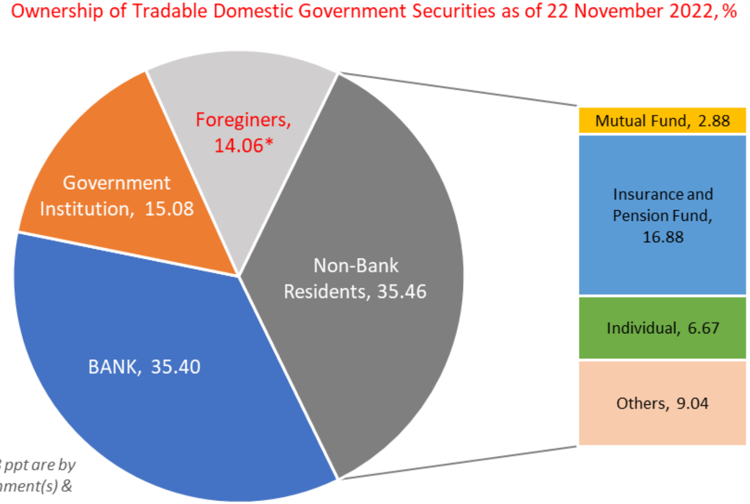
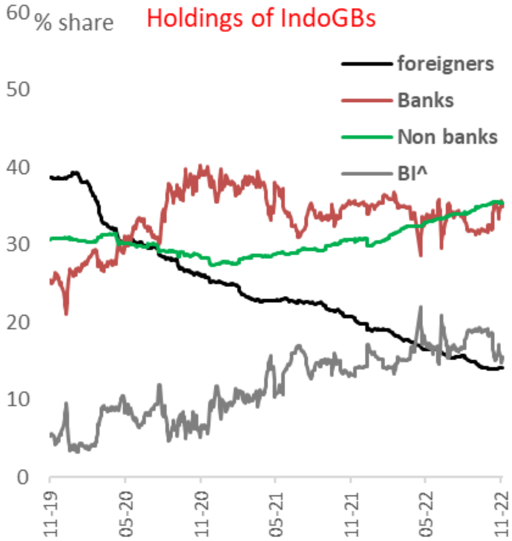
Source: DJPPR, OCBC
^DJPPR outlook for 2022; deficit is likely to come in narrower

IDR: foreign flows

- There had been heavy bond outflows until recently. Nominal yield differentials over USTs have not improved after much compression through the year. We expect **some mild upward adjustment in domestic yields** when UST yields stabilize, which shall **render the domestic bonds more appealing** to foreign investors. Foreign holding positions are light which is an added positive for potential bond inflows.



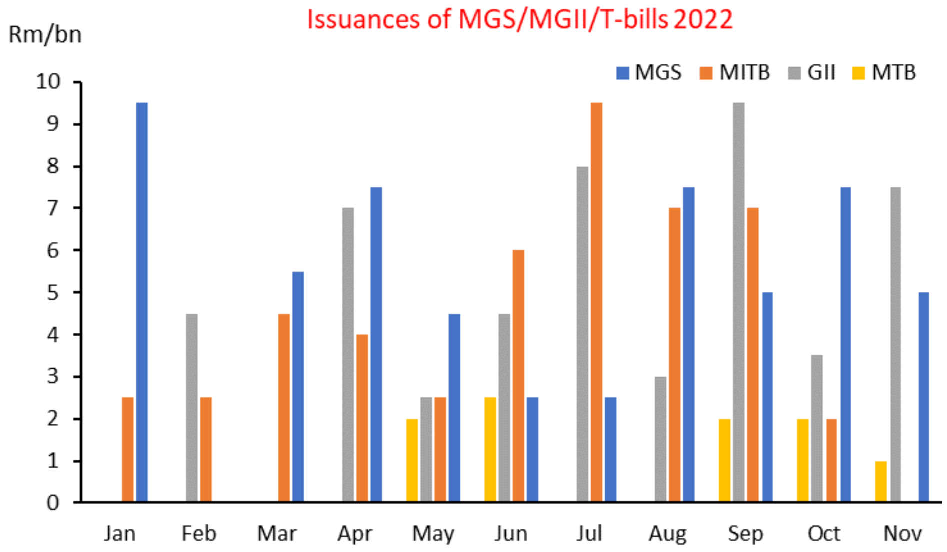
*Of which 3.98 ppt are by Foreign Government(s) & Central Bank



Source: Bloomberg, OCBC
^excluding those held for monetary operations

MYR: await Budget 2023

- Previous 2023 Budget put deficit at 5.5% of GDP which represented only a very modest fiscal consolidation plan; we expect 2023 gross MGS+MGII supply at MYR175-177bn based on that budget – which means net MGS supply would be fairly similar to that in 2022. This supply would push the debt level towards the 65% ceiling.
- Risk appears that the upcoming 2023 Budget will be more expansionary, adding marginally to supply.



Source: BNM, OCBC

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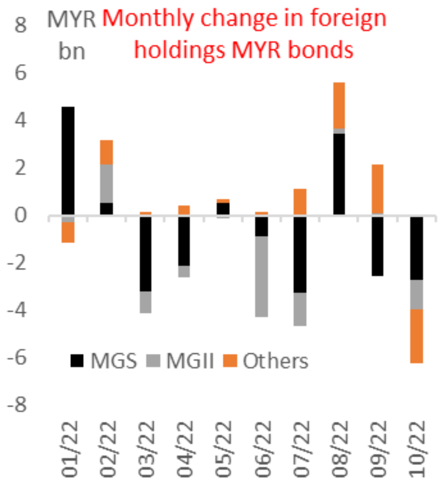
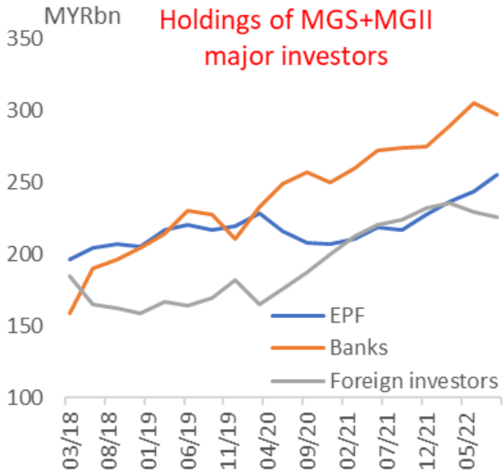
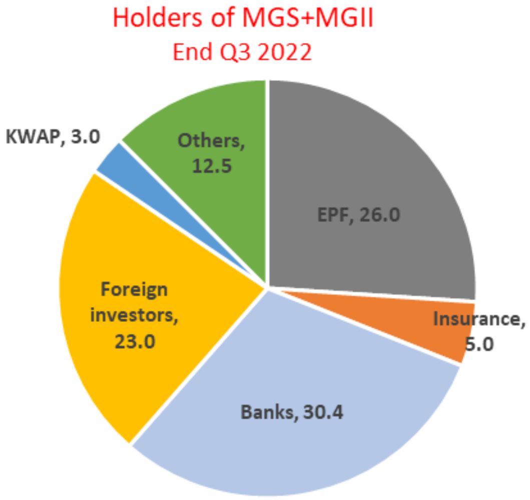
MYR: bond demand

- MGS and MGII together registered total outflows of MYR7.865bn in the year to October; demand from Banks and EPF has been supportive
- Demand from EPF shall stay steady, as the contribution rate has returned to 11% while there may be additional voluntary contributions. Demand from banks is likely continue to come from organic deposit growth.



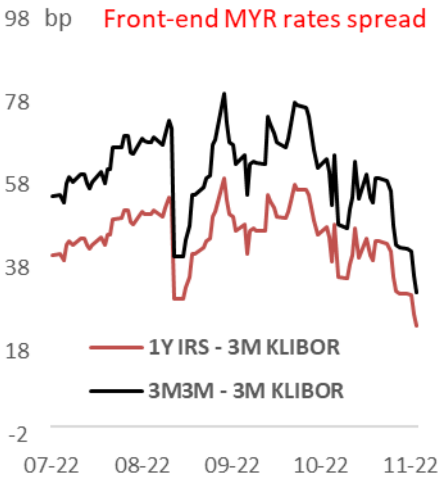


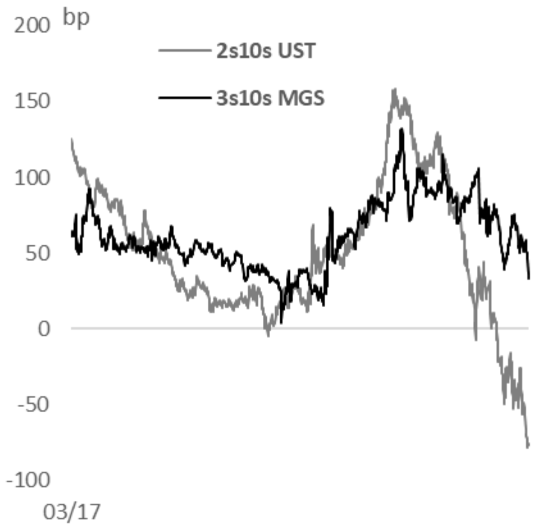


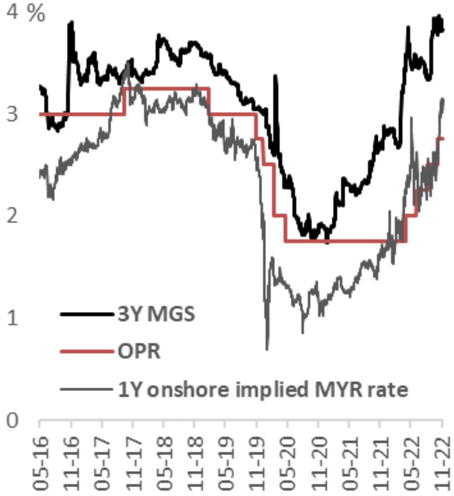
Source: Bloomberg, CEIC, OCBC

MYR rates

- We expect additional rate hikes of 50bp from BNM, which will bring the OPR to 3.25% by end Q1-2023. The 3Y MGS shall be resilient as it has stayed well ahead of the policy curve.
- **MGS curve to steepen**. The MGS curve has flattened substantially compared to own history, albeit not as much as the UST curve did; the 3s10s part is at more than two standard deviation above its 6-month average. Current curve shape, likely anchored front-end yield, and mild supply risk shall exert a steepening bias on the curve.







Source: Bloomberg, OCBC

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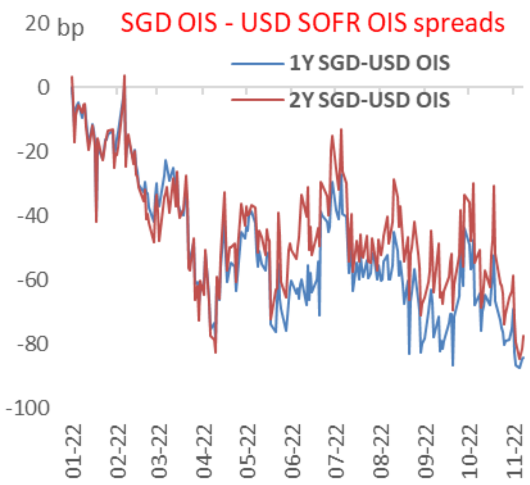
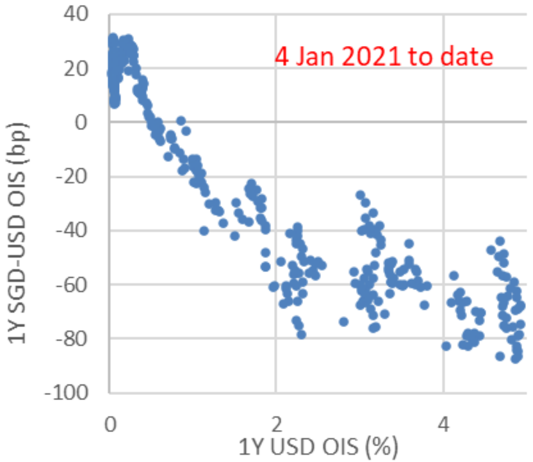
SGD rates: curve, and vs USD rates

- SGD rates and SGS have outperformed USD rates and USTs YTD, in line with our expectation, notwithstanding relatively big swings over the months. From here, room for further outperformance is limited given stretched levels and the prospect for USD rates to stabile.
- There is a small window of opportunity for further outperformance in 10Y SGS over UST for the rest of this year/early 2023, as issuance of long tenor SGS is back-loaded.
- Apart from this, **bias is for SGD-USD rates spread to widen back** (become less negative) mildly over the course of 2023.
- MAS policy: impact of MAS policy on SGD rates may be small, as spot will probably reflect most of the reaction.





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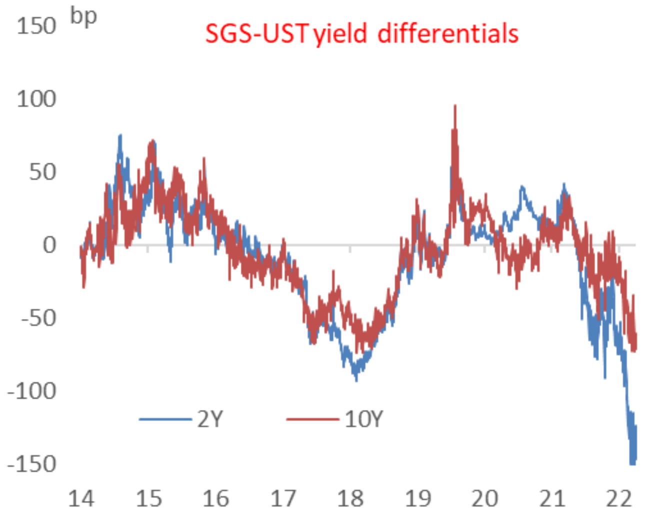
Source: Bloomberg, OCBC

2023 SGS issuances calendar

- The 2023 issuance calendar is broadly similar to the 2022 calendar in terms of the number of auctions and the tenors
- MAS expects outstanding SGS bonds “to grow at a healthy, albeit slower pace than in 2022”.
- Our **initial estimates for gross SGS issuance** (including the potential reopening of green infra) **are SGD27-30bn**; this represent smaller net issuances already (maturity is heavier in 2023 than in 2022).

No of auction (and syndication)

	2022	2023
2Y	2	2
5Y	4	3
10Y	2	2
15Y	0*	1
30Y	1	1
50Y (syn)	1	1^
Mini (optional)	1	2
Total	11	12



Source: MAS, Bloomberg, OCBC
*the mini auction in 2022 was 15Y
^subject to market conditions

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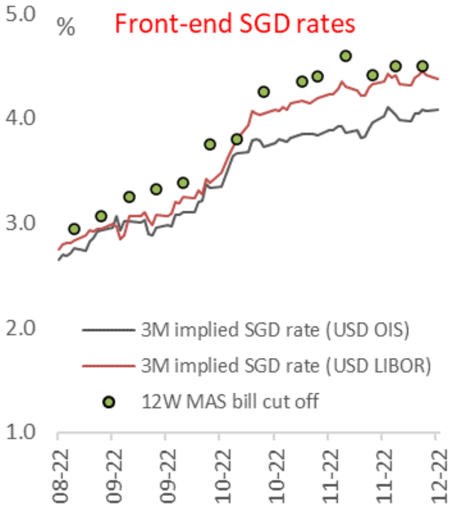
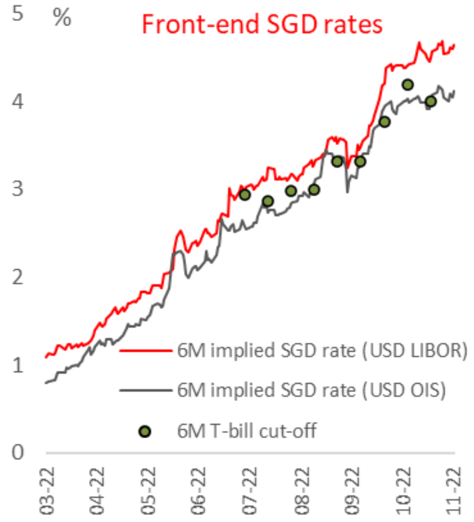
T-bills and MAS bills

- There is **limited spill-over from the relatively high T-bill and MAS bill yields to front-end SGS**, as bills and SGS are driven by different dynamics.
- Cut-offs at MAS bills have been mostly above the implied SGD rates from USD LIBOR during Q4; cut-offs at T-bills have been mostly between the implied SGD rates from USD LIBOR and SOFR, and sometimes nearer the lower end. This pattern is likely to stay, but with a potential for a narrowing in the spread between MAS bill cut-off and implied SGD rate after the year turns.

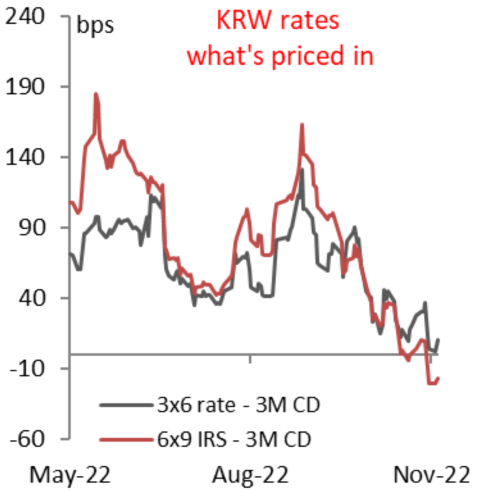


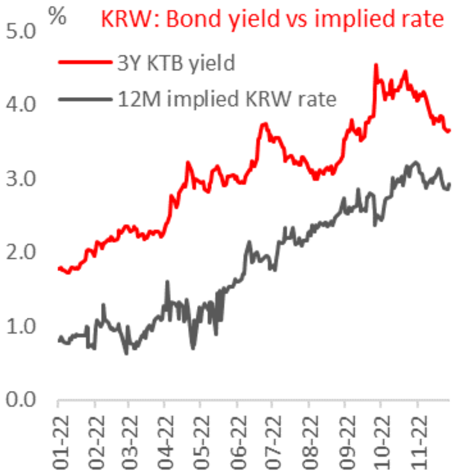


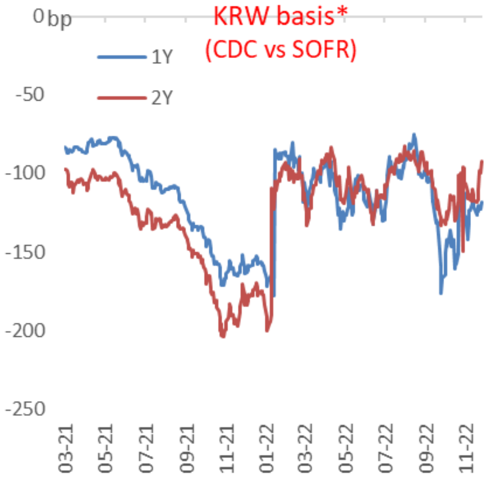
Source: MAS, Bloomberg, OCBC

KRW rates

- BoK is near the end of the hiking cycle. We expect one more 25bp hike in Q1-2023 bringing the policy rate to 3.50% - which is the "median dot" at the BoK. KRW IRS is not pricing in much further tightening.
- **Prospect for index inclusion**: the removal of the withholding tax is a key catalyst for index inclusion. Potential inflows are estimated at USD50-63bn over a 12 to 18-month period. The amount is significant compared to other BoP items.
- Real yield differentials are appealing; basis shall remain anchored providing pick-up for asset swap trade.



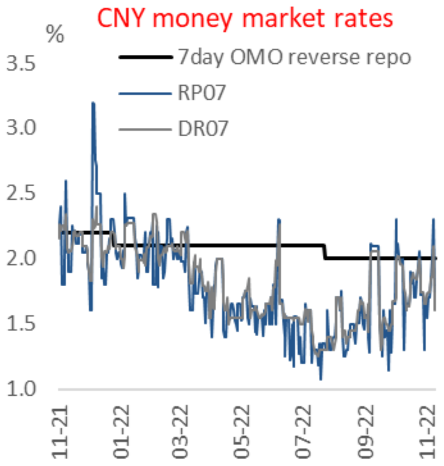


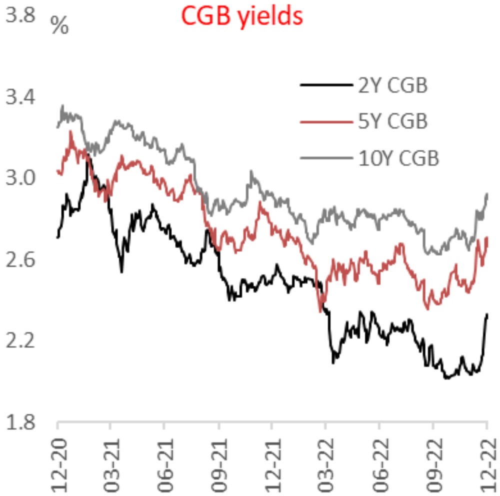


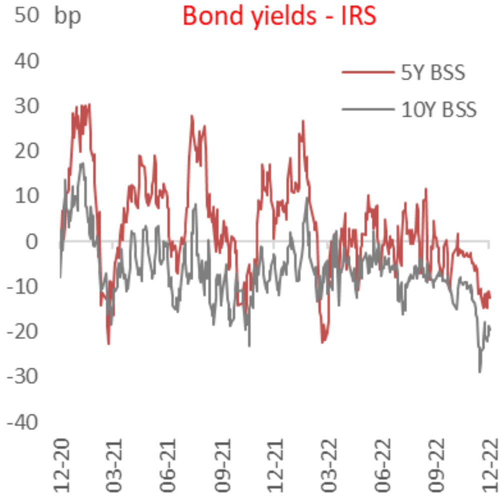
Source: Bloomberg, OCBC
*from KRW CCS (against SOFR) and KRW IRS (against CDC)

CNY rates: bottomed

- We have probably seen the lows in CNY rates and yields, upon more economic supportive measures while the monetary policy stance has become balanced (from an easing bias)
- The latest RRR cut shall be seen as a policy to support credit and hence growth, rather than pointing to monetary easing. We are more inclined to see the cut as a one-off with limited room for further cut.







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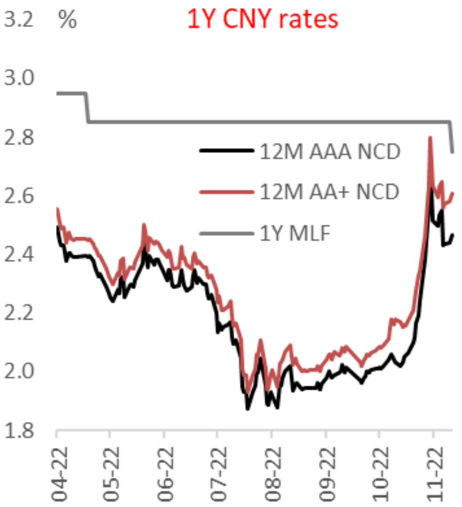
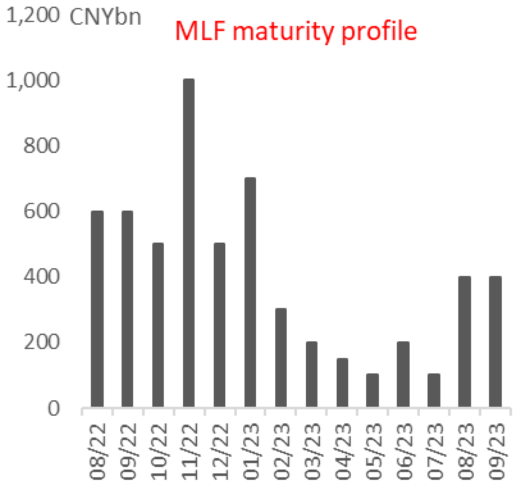
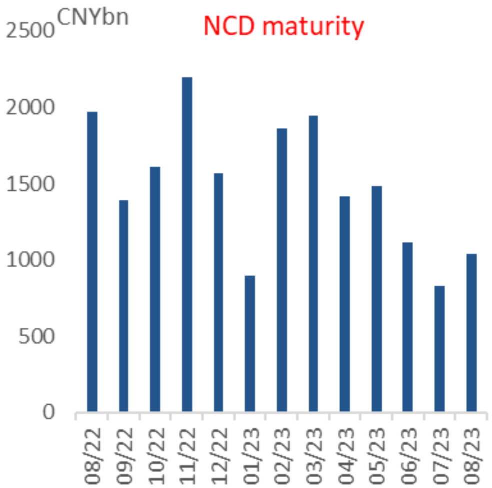
Source: Bloomberg, OCBC

CNY rates: liquidity

- Money market rates appear to be normalizing, from being suppressed for months. This reduces the prospect/needs for an MLF rate cut.
- MLF maturity profile turns light beyond January; Monthly NCD maturity stays above the CNY1trn mark (but not heavier than during 2022) for February-June. Overall, there is no intense pre-set liquidity pressure point.







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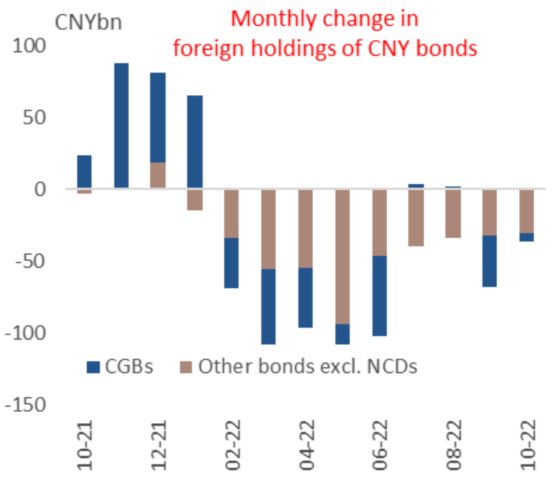
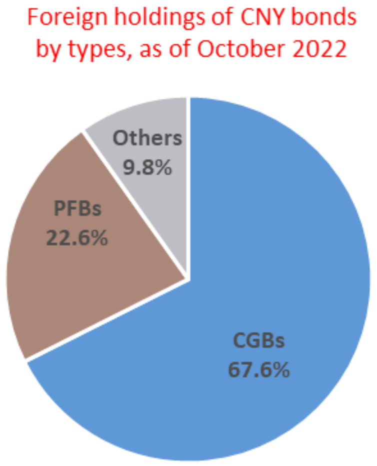
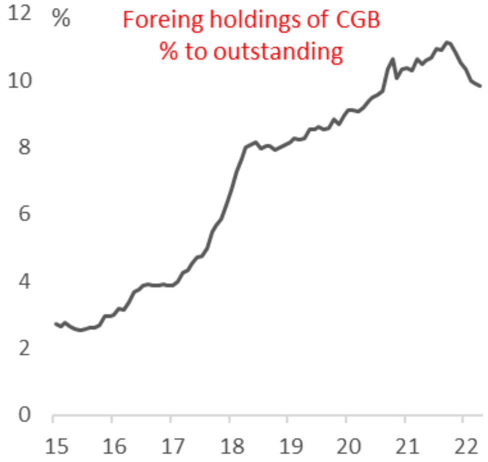
Source: Bloomberg, CEIC, OCBC

CNY rates: bond flows

- Year-to-October bond outflows amounted to CNY604bn, outflows from CGBs amounted to CNY169bn; this was despite the inclusion into the FSTE WGBI which started in October 2021.
- We expect inflows to come back after some further upward adjustment in CGB yields, as passive flows (estimated at CNY23-24bn per month from October 2021) are yet to be deployed.



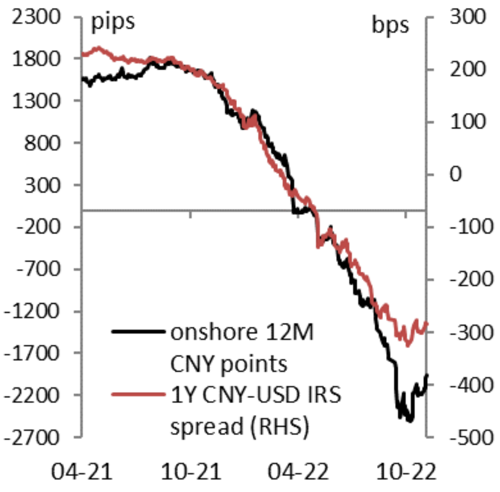


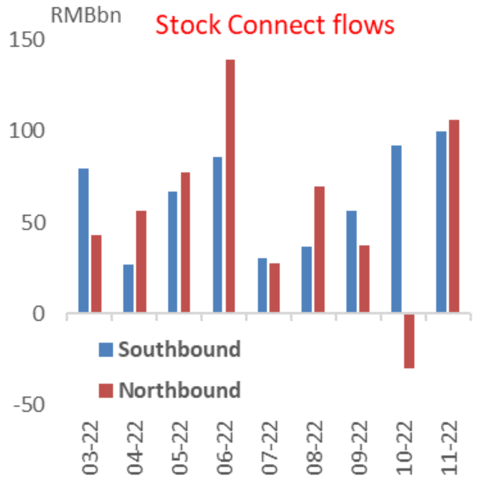


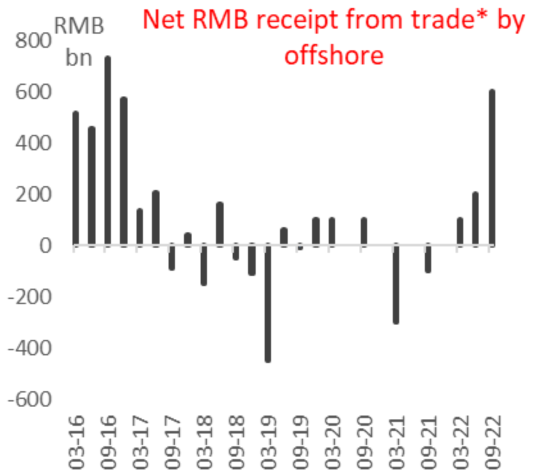
Source: CEIC, OCBC
^exclude NCDs; on Chinabond and Shanghai Clearing

CNH points and liquidity

- CNY-USD rates differentials are unlikely to be much further compressed after the big moves in 2022, given expected stabilization in USD rates. Near-term direction for USD rates is however unstable – we see an upward bias; we prefer to wait for better entry levels for paid positions at back-end CNH points; pay-on-dips is the strategy on a multi-month horizon.
- As CNY-USD rates differentials likely become more stable, CNH liquidity will come back as a factor driving the points: watch Stock Connect flows and trade flows.







Source: Bloomberg, CEIC, OCBC
*include C/A and FDI items

1H2023 FX Outlook

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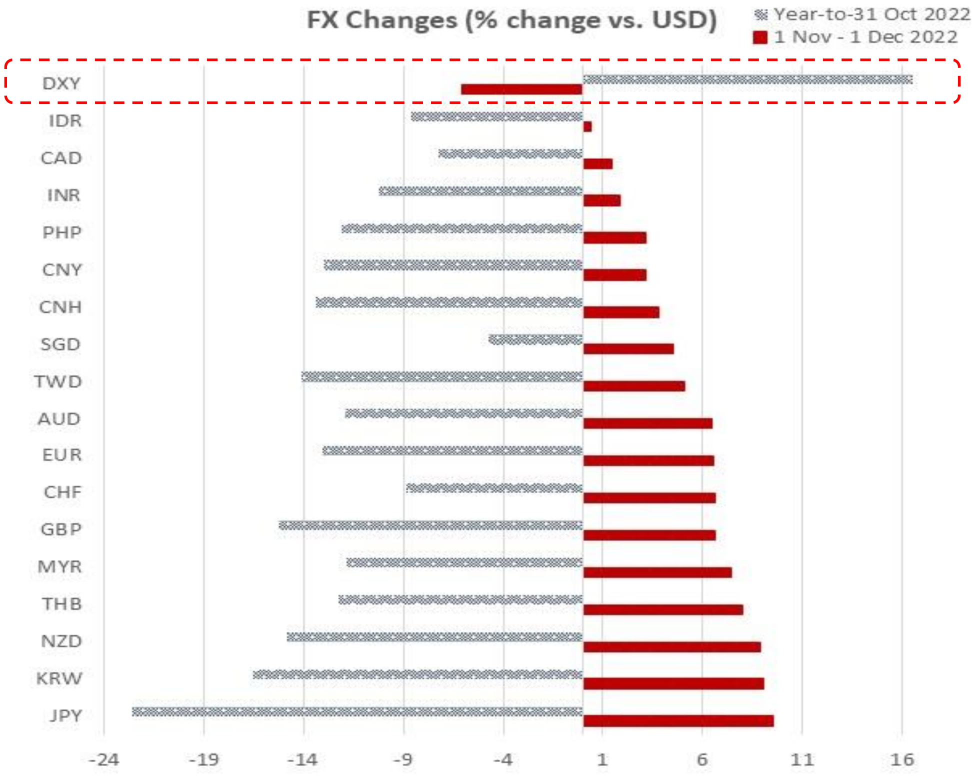
An Overview: Dollar's Dominance Shows Signs of Withering



Long USD no longer the consensus trade. Fed policy calibration amid moderation in price pressures imply a more moderate-to-soft USD profile

Most FX rebounded in Nov as USD corrected sharply. Traditional high-beta FX such as **KRW, NZD, AUD were some of the biggest gainers MTD.**

NZD rebounded sharply as RBNZ stepped up pace of policy tightening

KRW, THB and JPY rebounded sharply on improvement in current account balances while **IDR underperformed** as current account balance is projected to deteriorate as coal prices fall

MYR playing catch-up to gains in other AXJs as election uncertainty dissipates

SGD remains relatively resilient compared to its peers on stronger macro (i.e. current account improvement, continuous FDI inflows, etc.) and policy tightening bias. But room for S$ strength to ease vs. peers as USD strength takes a backseat and risk aversion faded

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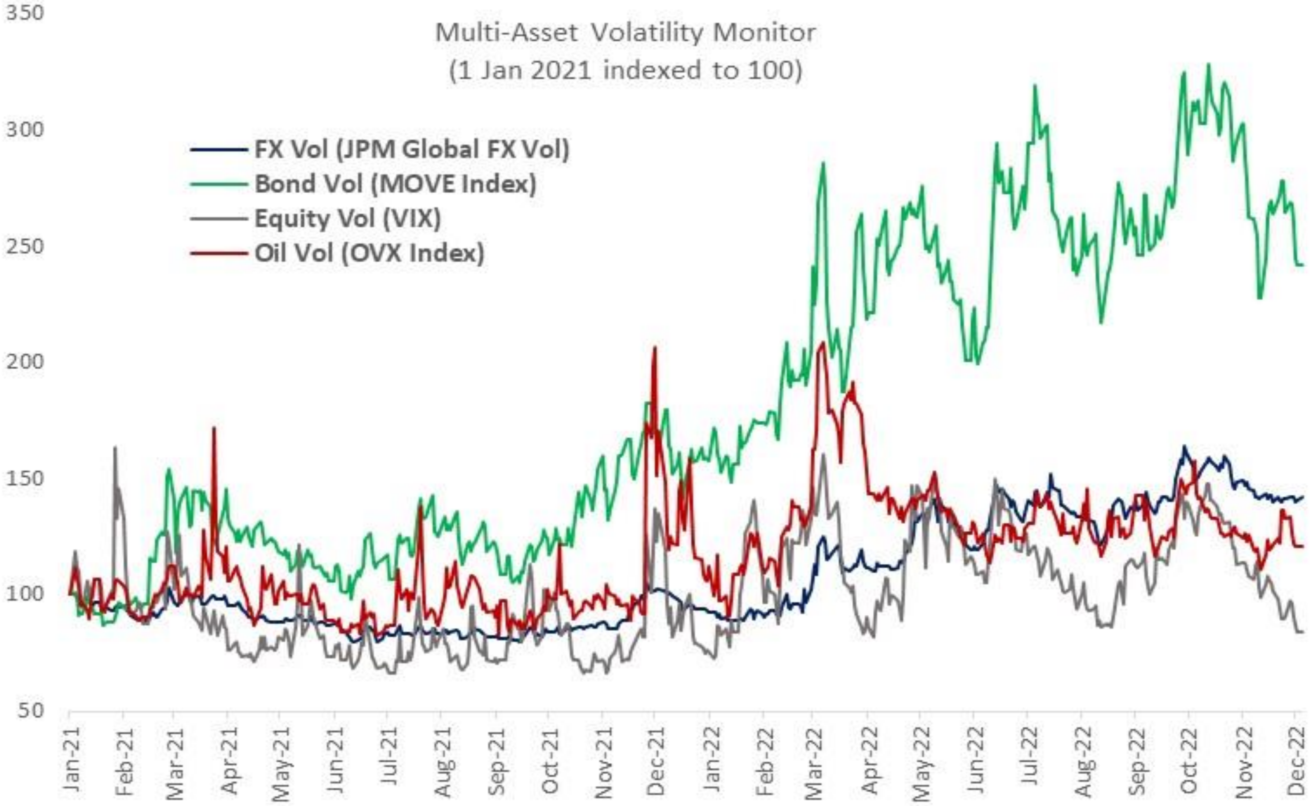
Note: MTD data as of 1 Dec 2022
Source: Bloomberg, OCBC

Most Asset Volatilities Have Eased; Bond Vol Still High



Source: Bloomberg, OCBC

Key FX Thematics

- **China Reopening –**
  - Cautiously optimistic that China is on a path towards gradual reopening of economy as policymakers calibrate covid restrictions
  - Anticipation for China reopening and recently announced property support measures should **benefit RMB, RMB-assets and broad sentiments in the region**
  - In the FX space, **commodity-linked FX (i.e. AUD), tourism-linked FX (i.e. THB), trade-linked (i.e. MYR), risk-proxy FX (i.e. KRW) should outperform**

- **Fed Policy Calibration –**
  - Fed-BoJ policy divergence was the key driver fueling USDJPY gain YTD**.** But a Fed policy calibration thematic implies that UST-JGB yield differentials can narrow
  - Increasingly there is also rising prospects of potential BoJ tweaks in monetary policy/ exit NIRP
  - Further unwinding of massive JPY shorts can lead to further **downside in USDJPY**
  - **Long Gold** as a proxy for Fed policy calibration

- **Relative Value Play –**
  - SGD was more resilient relative to regional peers amid risk-off environment
  - But going forward, with USD on a more moderate-to-soft profile and risk aversion taking a backseat, we see room for S$ strength to taper selectively against some Asian FX that have been oversold
  - **Short S$ vs. Long A$, THB, KRW, JPY**

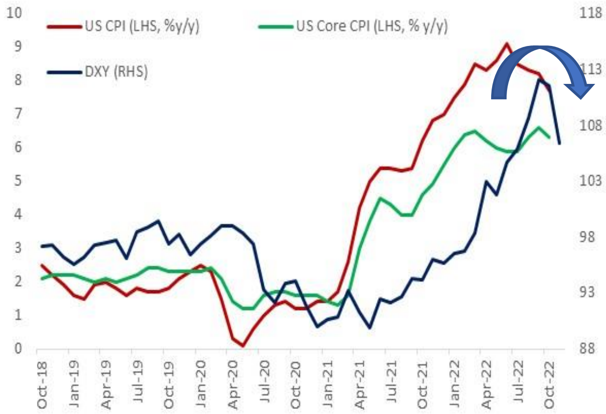
USD: Looking for a Moderate-to-Softer Dollar Profile

Long USD No Longer a Consensus Trade

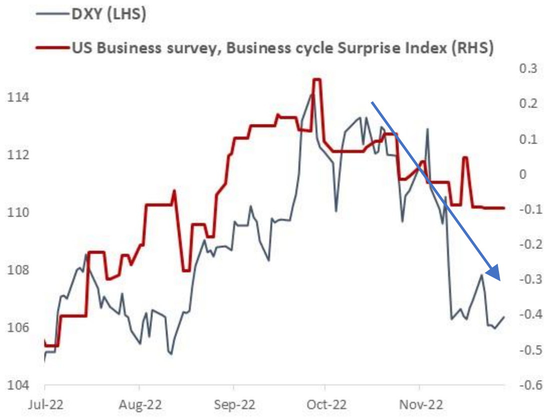
- Softer US inflation trajectory can lead to further calibration in Fed tightening.
- Fed policy calibration implies there is room for USD to correct lower.
- Bear in mind USD strength was up as much as 20% at one point YTD in Sep.
- More material slowdown in price pressure could lead to further unwinding of stretch USD long position and that can imply a softer USD.

- That said, we retain some degree of caution as policy calibration does not mean the Fed is done with tightening. Rates are still elevated and going higher, albeit at a slower pace potentially. Hence a profile of a moderate-to-softer USD profile.

Softer CPI Sparked Off USD's Decline



DXY reacting to US data disappointment



DXY Long Positioning Correcting from Stretched Levels, alongside the pullback lower in USD

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Source: Bloomberg, OCBC

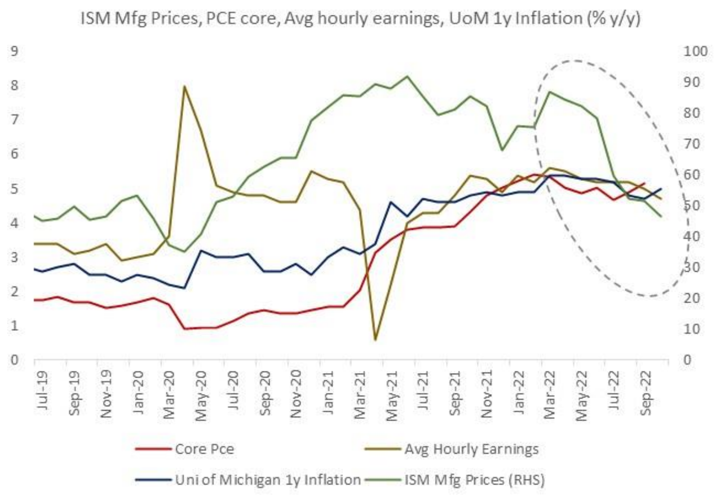
USD: Signs of Price Pressures Easing; Need More Material Pullback

More Entrenched Policy Calibration Thematic Can Weigh on USD

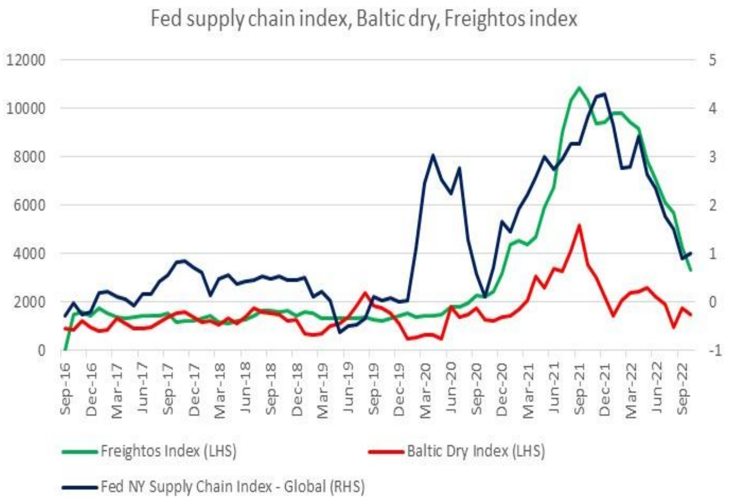
So apart from looking at common measures of inflation like CPI. We also look at other price measures such as ISM mfg prices, wage growth, inflation expectations as well as supply chain price pressures. And they have largely fallen over the past few readings.

More evidence of material pullback in price pressure is needed. A case of headline CPI heading lower towards Fed's target should see a Fed pause. We hold to our house view for 50bps Fed hike in Dec, followed by 50bps in 1Q 2023, and a pause thereafter.

Tentative signs of price pressures easing



Signs of supply chain pressure easing



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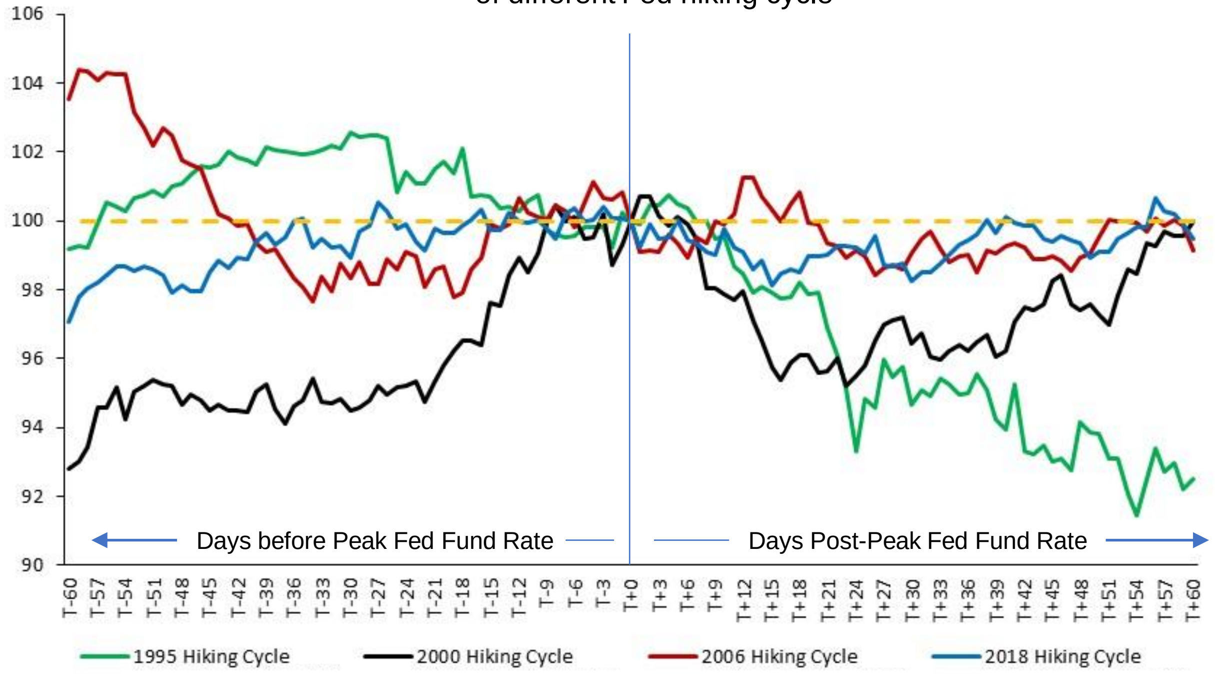
Source: Bloomberg, OCBC

USD: Limited Room for USD Upside On Peak Fed Fund Rate

DXY Indexed to 100 at peak Fed fund rate of different Fed hiking cycle



An event study on DXY price action across the last 4 Fed hiking cycles since 1994.

DXY typically consolidates around the peak of Fed fund rate in each cycle during the window of T-6 and T+6.

Over a longer trading window of T+60, it was observed that the room for DXY upside was fairly limited

To some extent, the current Fed tightening cycle is somewhat similar to the 1994 cycle. Fed's Bullard had earlier singled out 1994 as an example on how fast the Fed could tighten (+300bps in 1 year) and how soft-landing was achieved. DXY fell ~8% post-peak tightening.

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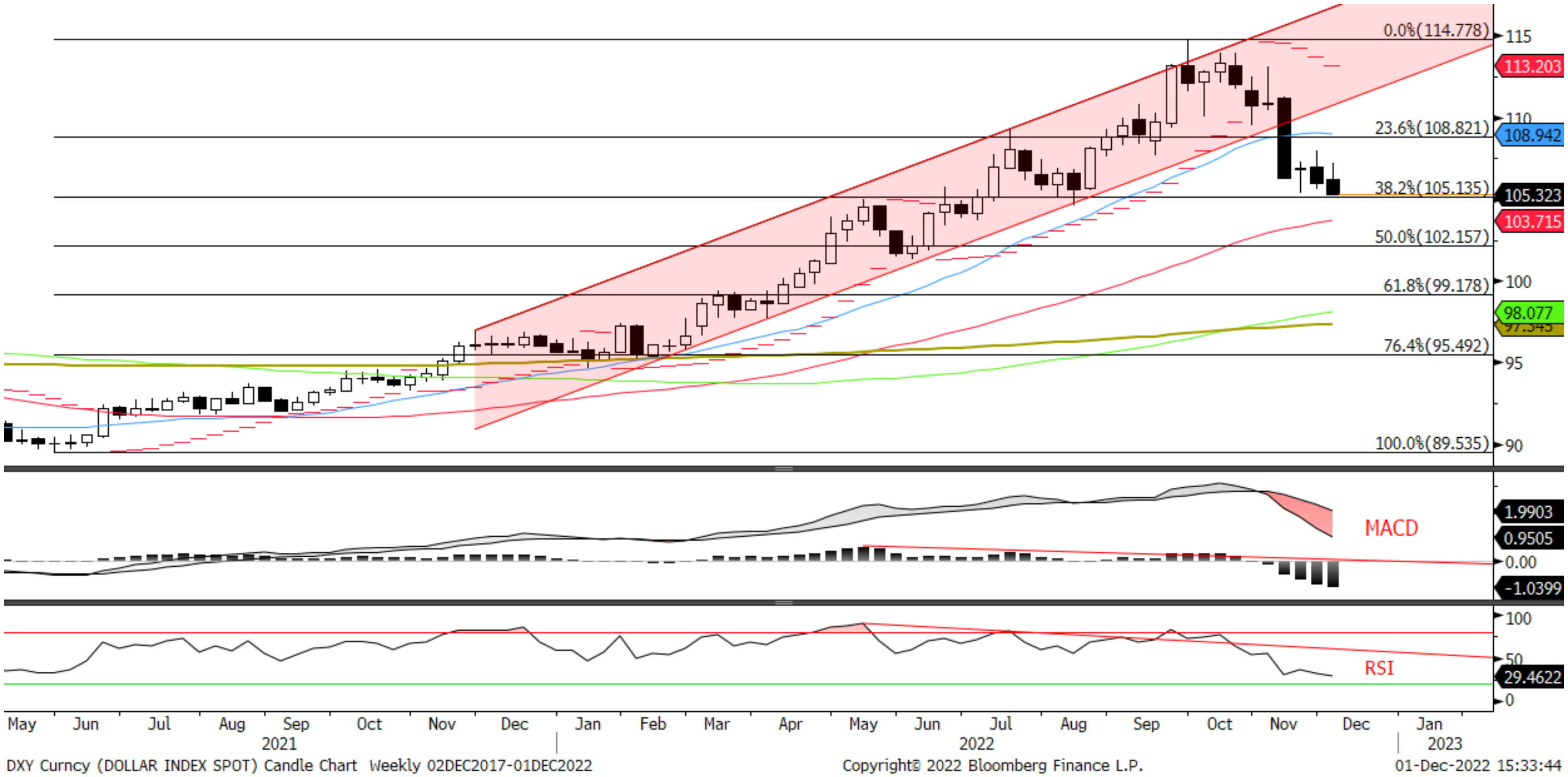
Source: Bloomberg, OCBC

DXY – Long-USD Trend Turned; Sell-on-Rally Preferred



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Source: Bloomberg, OCBC

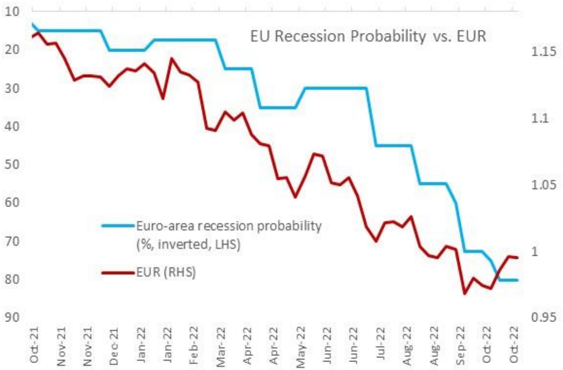
EUR: Neutral Outlook

Continue to Monitor Development as Further Deterioration Warrant a Re-assessment in Risks

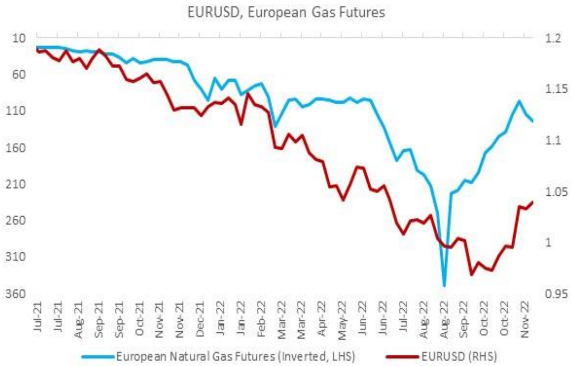
- Mild recession risks priced while inflation concerns eased slightly
- ECB tightening continues to provide some support for EUR
- Stabilisation in gas prices amid fading concerns of supply shortage helps to stabilise EUR
- EUR getting used to war premium; ceasefire would be a positive wildcard

But risks remain: (1) how severe recession turns out to be; (2) re-escalation in Russian-Ukraine – energy and inflation risks; (3) if USD strength returns with a vengeance (global risk-off, or Fed resumes aggressive tightening)

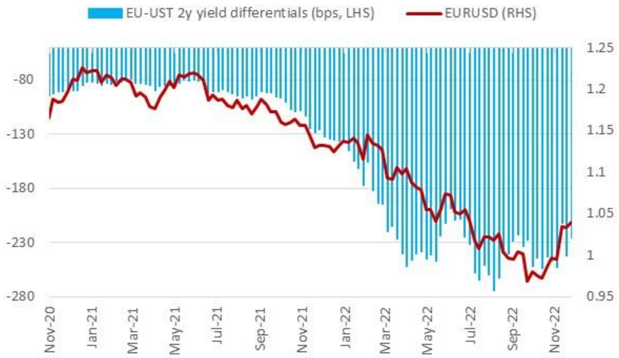
Rising Recession Fears Drove EUR's Decline



Stabilisation in gas prices helps to stabilize EUR

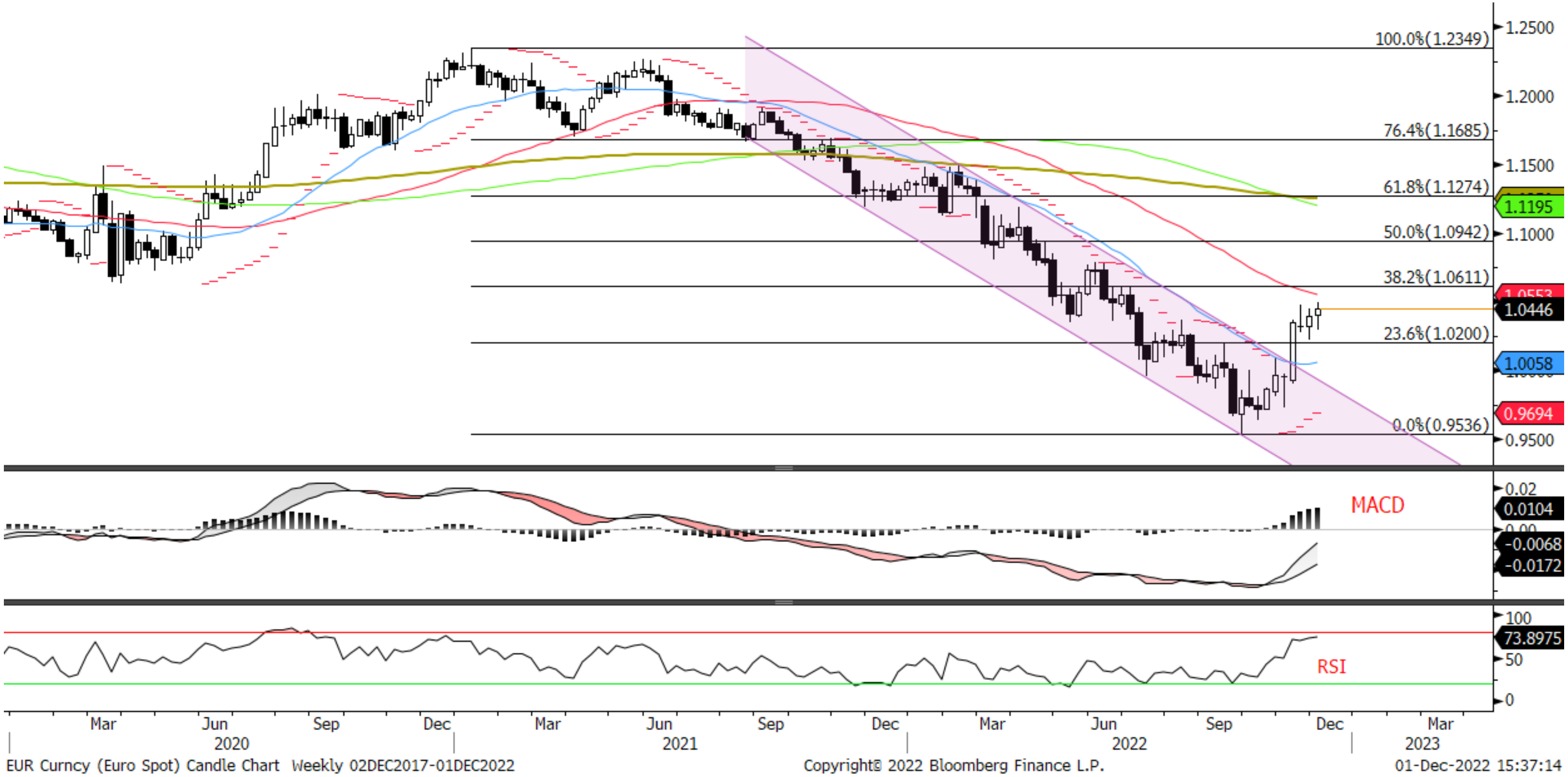


Improvement in EU-UST yield differentials mitigates EUR's decline



Source: Bloomberg, OCBC

EURUSD – Broken Out of Its Bearish Trend

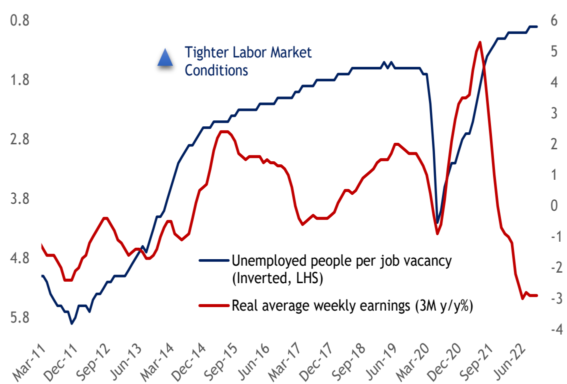


Source: Bloomberg, OCBC

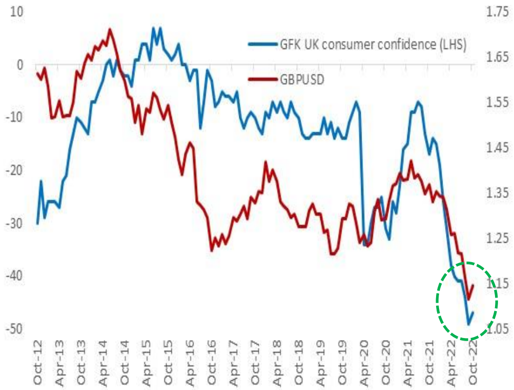
GBP: Slight Cautious as Stagflation Concerns Weigh Even As Confidence Crisis Fades

GBP's sharp rebound could see pace of gains slow ahead of key resistance

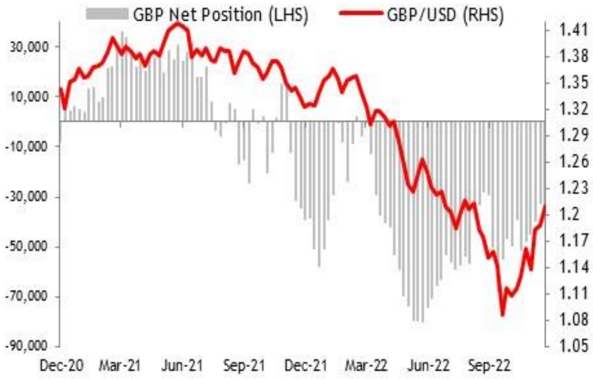
Tight Labor Market Stifles Business Growth while UK consumer faces cost-of-living Squeeze



Improvement in consumer confidence may help with a turnaround in GBP



Further unwinding in GBP shorts can aid GBP's recovery



We **turned slightly less bearish on GBP outlook** as newly appointed leaders, Sunak as PM and Hunt as Chancellor suggest that the government and policymaking are in a safer pair of hands (restore market confidence).

Autumn statement (17 Nov) shows UK will undergo a painful but necessary phase of fiscal consolidation, that included GBP30bn of spending cuts and GBP25bn of tax increases. A credible fiscal plan underscores policymakers' resolve to fiscal discipline

Moderate-to-soft USD profile allows for GBP to recover but weaker domestic fundamentals (stagflation, consumer squeeze, etc.) could restraint the extent of GBP's recovery

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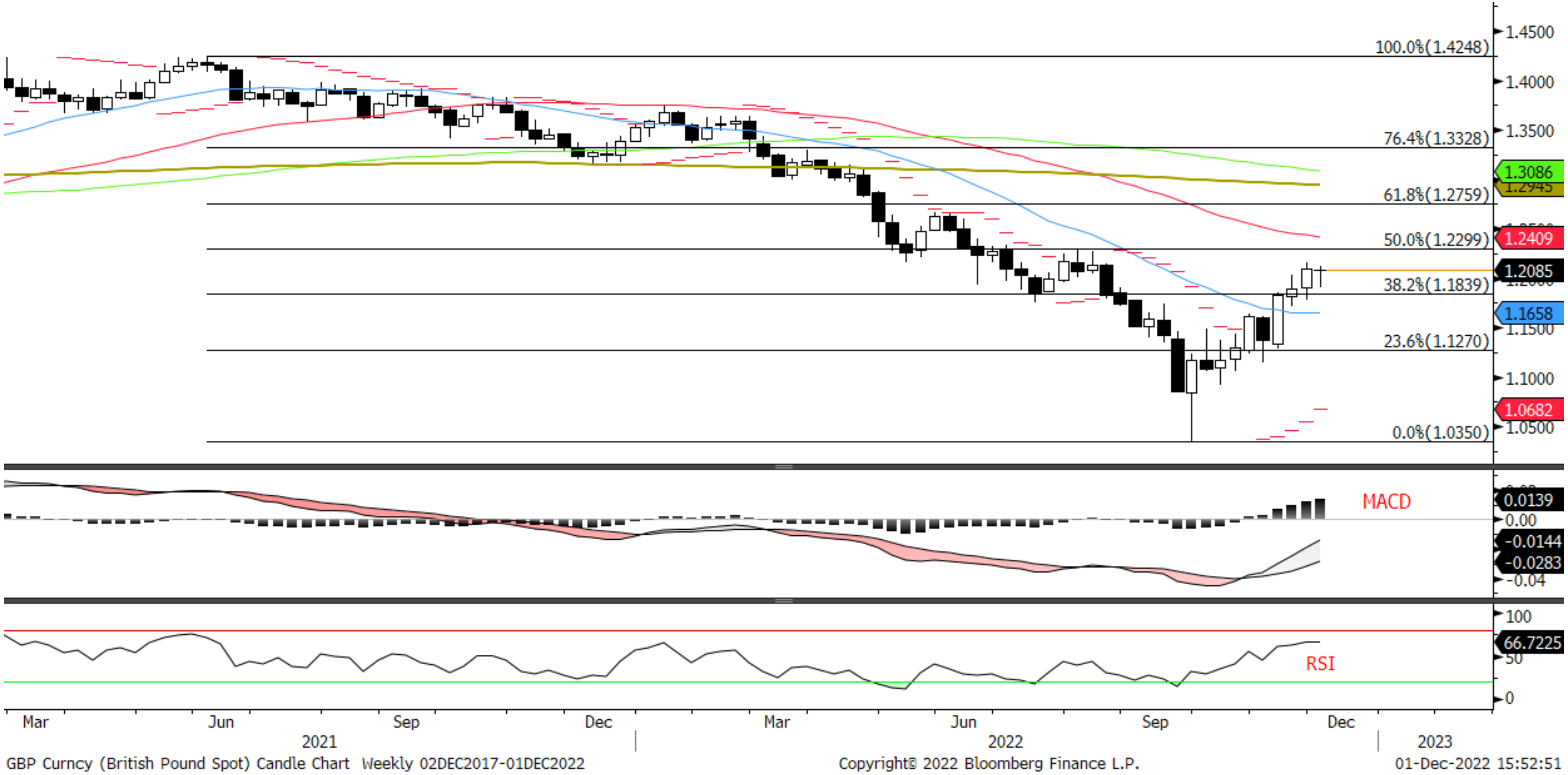
Source: Bloomberg, OCBC

GBPUSD – Still On the Recovery though Pace of Gains May Slow



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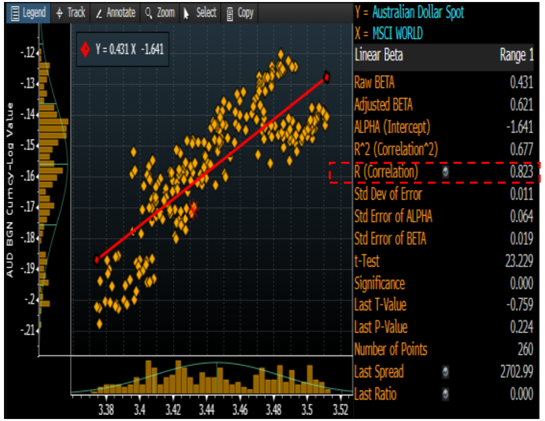
Source: Bloomberg, OCBC

AUD: Recovery Underway though Global Growth Concerns May Restraint Gains

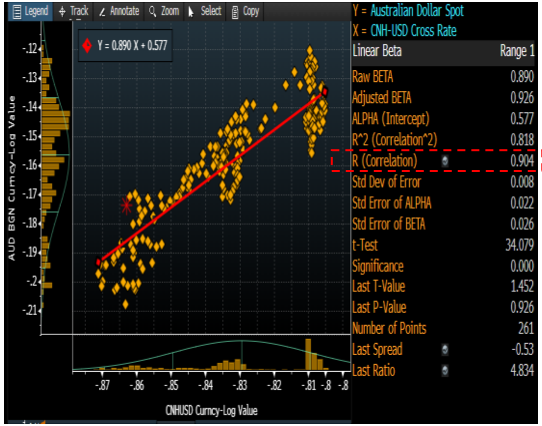
- AUD is a highly sensitive currency to global growth cycles, China's commodity demand and RMB
- Cumulative decline of over 20% since Mar-2021 was a reflection of growth concerns, slowing China growth, zero covid policy
- Anticipation for China reopening and a more moderate-to-soft USD profile can support AUD's recovery.

Key risk factors to watch: 1/ the extent of CNH swings; 2/ if USD strength returns and 3/ global risk appetite

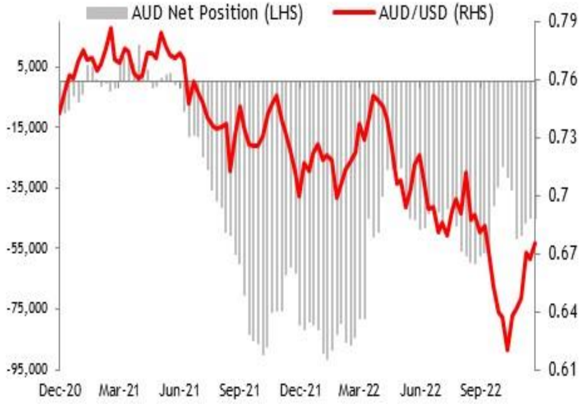
AUD Highly Correlated with Equity Movement



AUD Highly Correlated with RMB Movement



Further Unwinding of AUD Shorts Could Support AUD's Recovery



Source: Bloomberg, CFTC Positioning, OCBC

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AUDUSD – Gains Could Extend

OCBC Bank

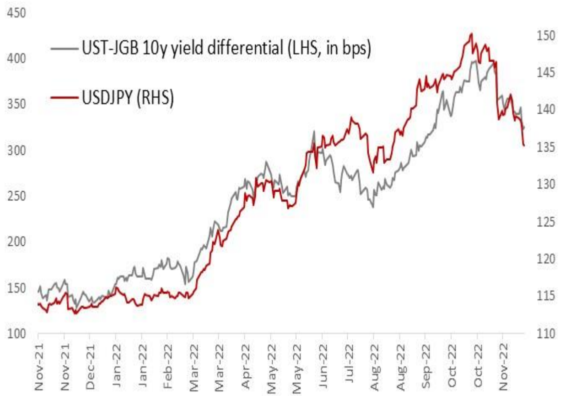
Source: Bloomberg, OCBC

JPY: Likely to Score an Outperformance

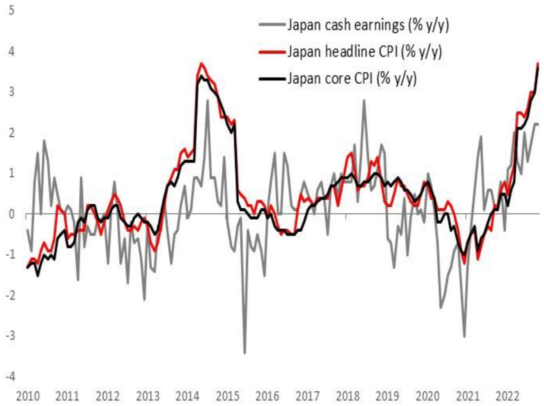
- USDJPY likely past-its-peak as Fed policy calibration suggests that UST-JGB yield differentials can narrow from wide gap
- Potential withdrawal of monetary stimulus if trend inflation overshoots expectations and stay above its 2% target
    - BoJ member Noguchi highlighted there is a chance BoJ will act pre-emptively
    - BoJ member Tamura said the right time to conduct policy assessment would be “soon” or “a little later”
- Room for further unwinding of short JPY position suggest room for JPY to recover
- Long JPY also serves as a proxy-trade to for growth slowdown risks or geopolitical hedge

Key risk factors to watch: 1/ if Fed resumes aggressive tightening; 2/ BoJ flip-flops

UST-JGB Yield Differentials Improving



JP Wage Rise in Tandem with CPI

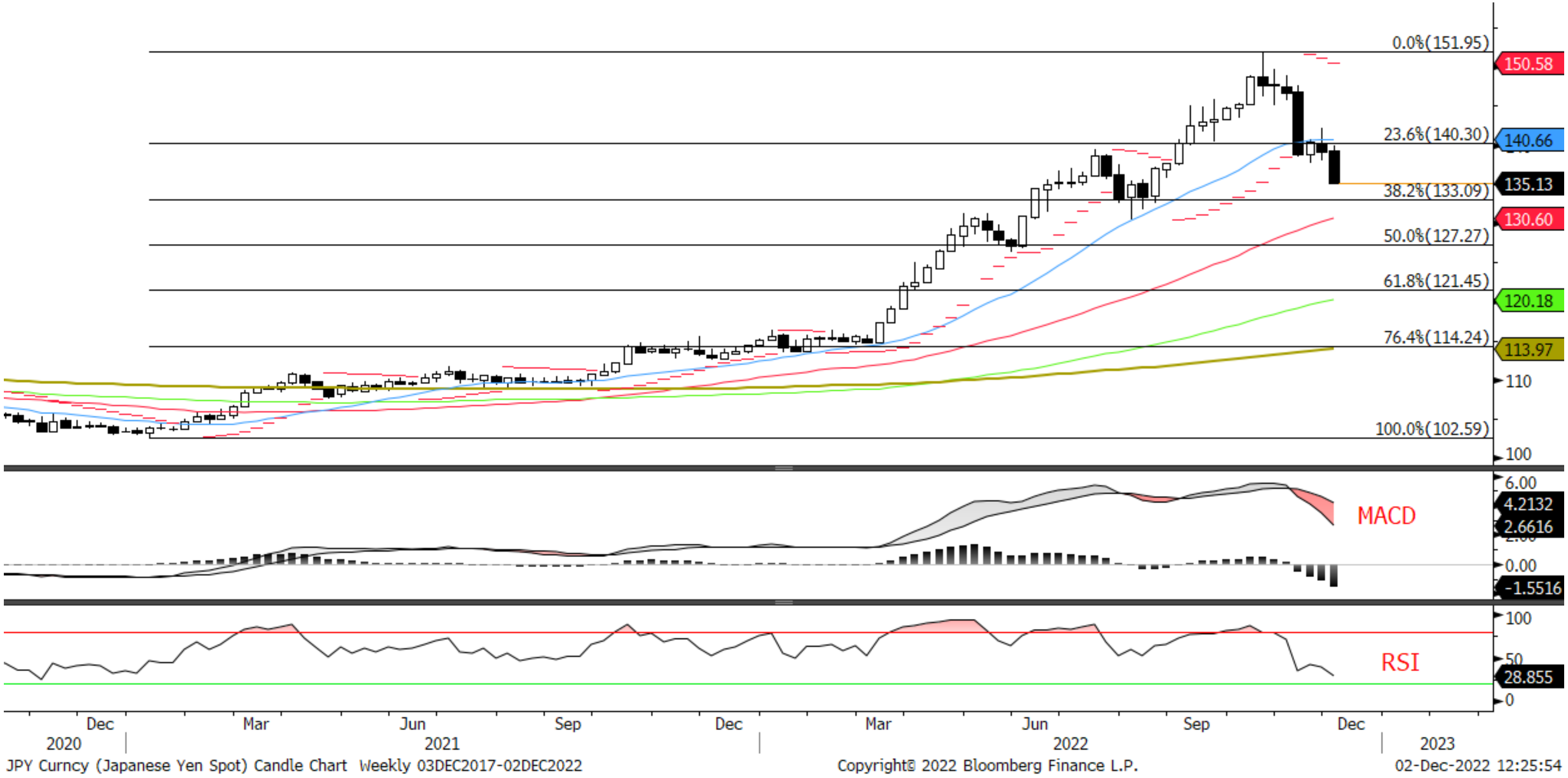


Further Unwinding of JPY Shorts Can Accelerate JPY Gains

OCBC Bank

Source: Bloomberg, CFTC Positioning, OCBC

USDJPY – Peaked; Bearish Momentum Underway



Source: Bloomberg, OCBC

RMB – Cautiously Optimistic on Reopening Hopes; Support Measures Underway

Can Benefit commodity-linked FX (AUD), tourism-linked FX (THB), trade-linked (MYR) and risk-proxy FX (KRW)

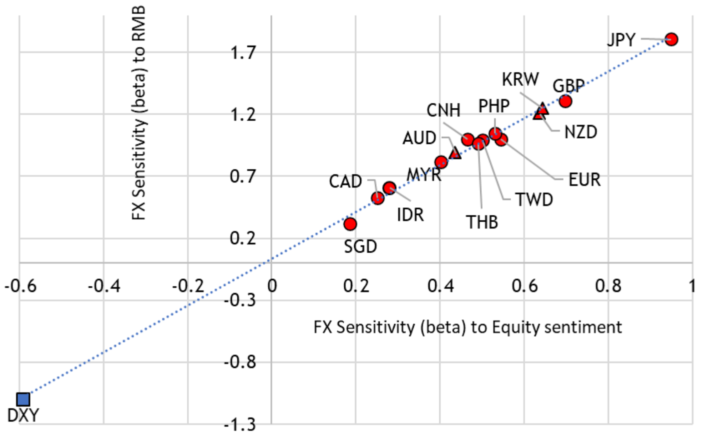
- Nearing endgame of zero covid policy. Protests and production slowdown were temporary stumbling blocks

- Path towards gradual relaxation of covid restrictions and economy reopening should continue to benefit RMB and lead to acceleration of portfolio inflows especially when domestic equity and bond markets were battered down (attractive valuations)
    - Local governments need time to digest and implement the 20point covid measures that were issued by central government. In fact over the past few days, there were news flow on covid easing in China

- Regulatory crackdown on big tech is largely done. Property support measures, economic support policies (cut to RRR) to help stabilise growth and sentiments

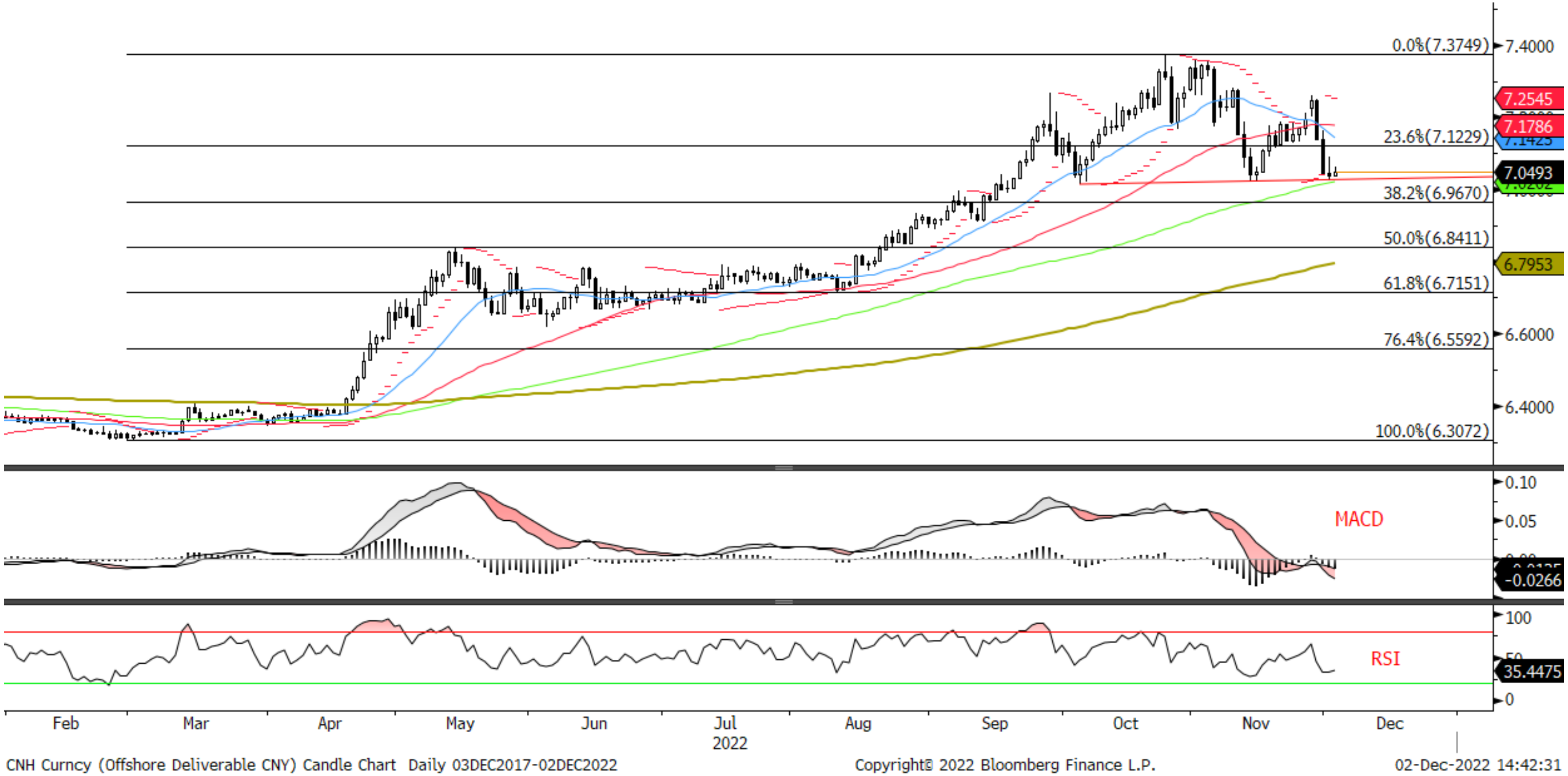
RMB-linked assets and RMB Can Benefit on Reopening Thematic

Asian FX Can Outperform on Risk-On and RMB Gains



Note: RHS chart: OLS on daily log values over last 1y
Source: Bloomberg, OCBC

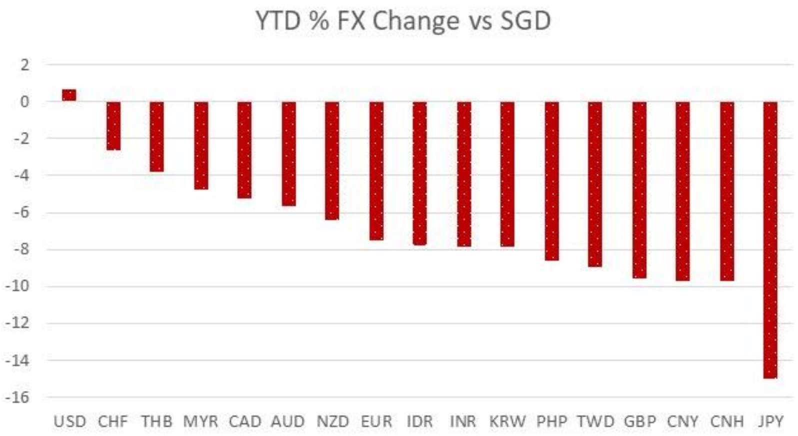
USDCNH – Room for Further Downside

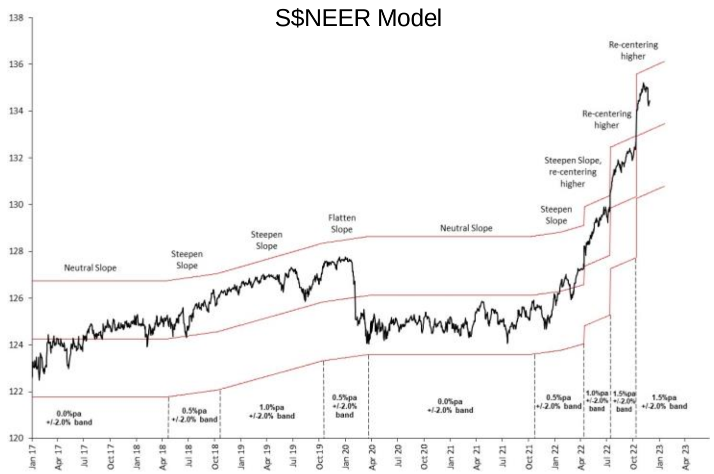


Source: Bloomberg, OCBC

SGD – Resilient but No Outperformance Expected

- Retain a slightly bullish outlook on SGD on the back of still-hawkish MAS and resilient macro-fundamentals (fiscal buffers, current account surplus).
- The room for further tightening (i.e. slope steepening) remains intact if inflationary pressures continue.
- YTD, SGD was more resilient relative to regional peers amid risk-off environment.
- But going forward with USD on a more moderate-to-soft profile and risk aversion taking a backseat, we see room for S$ strength to taper selectively against some AxJs that have been oversold this year. In particular, we favor those FX that also saw current account improvements, and that includes THB and KRW. Technically we also favor long AUDSGD on dips.





Source: Bloomberg YTD as of 1 Dec 2022, OCBC

USDSGD – Breaking Out of Bullish Trend Channel

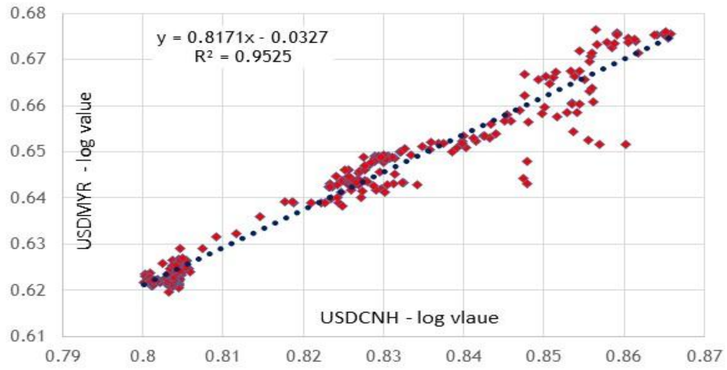
Source: Bloomberg, OCBC

MYR – Constructive Outlook; Political Uncertainties Fade

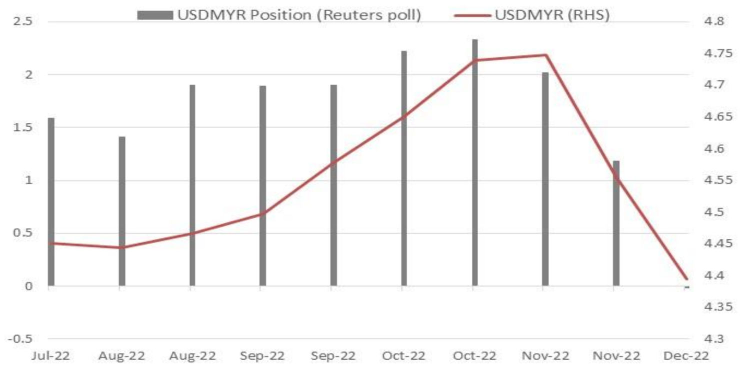
Domestic Macro Resilience while External Environment Turning Conducive

- Sharp sell-off in USDMYR continued as 10th Prime Minister was sworn in (24 Nov), ushering some stability for domestic sentiments
- Focus now on the supplementary budget in Dec and confidence vote (19 Dec). Uncertainties on this front could slow MYR's appreciation going forward but meantime MYR is playing catch-up to gains in other AXJs as USD weakness extended and election uncertainties in Malaysia dissipate.
- Recovery momentum, driven by domestic demand as Malaysia economy reopens and current account surplus intact. Trade picture remains promising with both exports and imports sustaining double-digit growth so far this year
- Fed policy calibration and China reopening hopes create a favourable external environment

MYR moves highly correlated with RMB moves



Build-up of MYR Longs can accelerate MYR Gains



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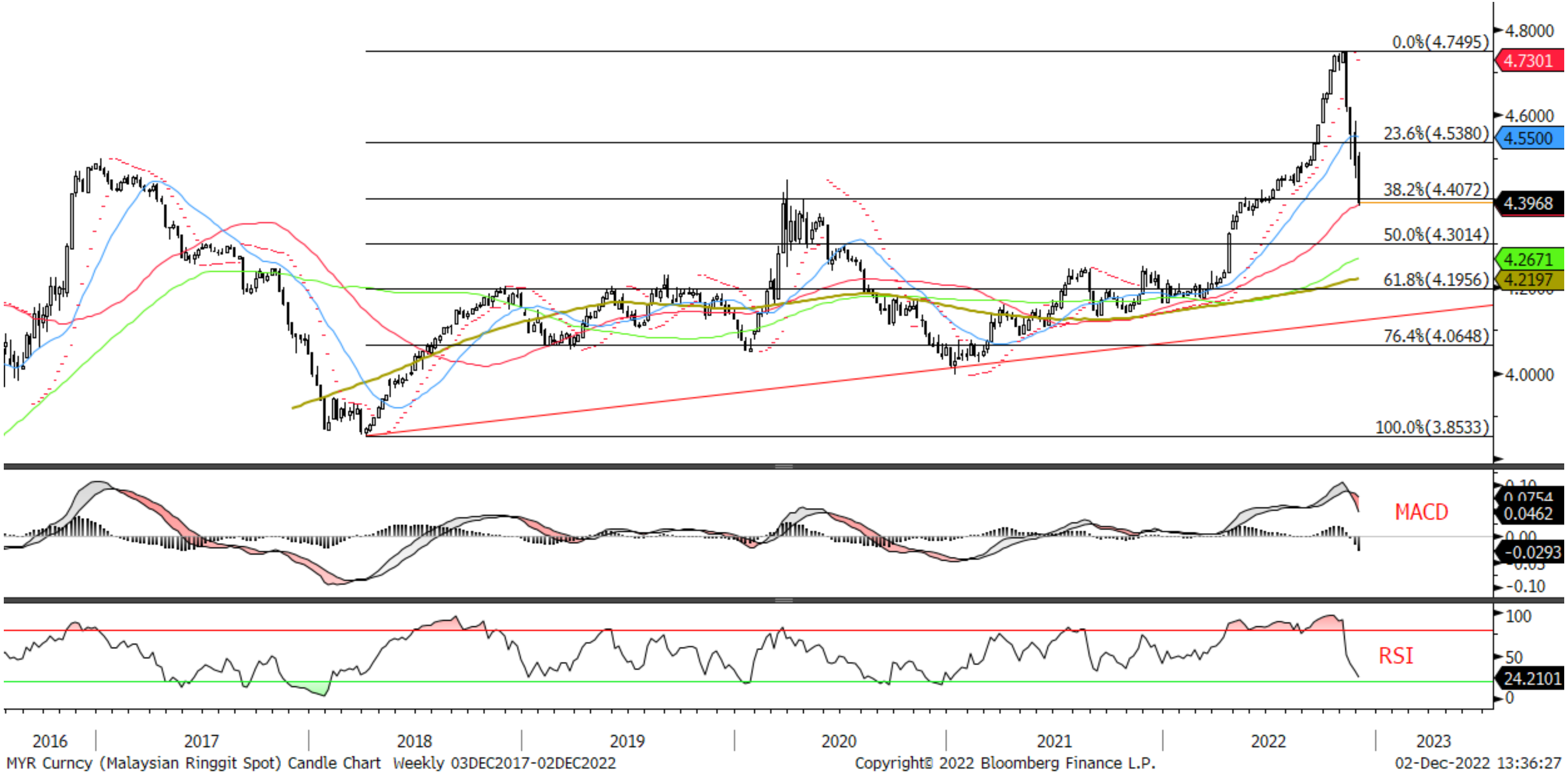
Source: Bloomberg, Reuters poll on Asian FX positioning (latest avail 1 Dec), OCBC

USDMYR – Correcting From Stretched Levels



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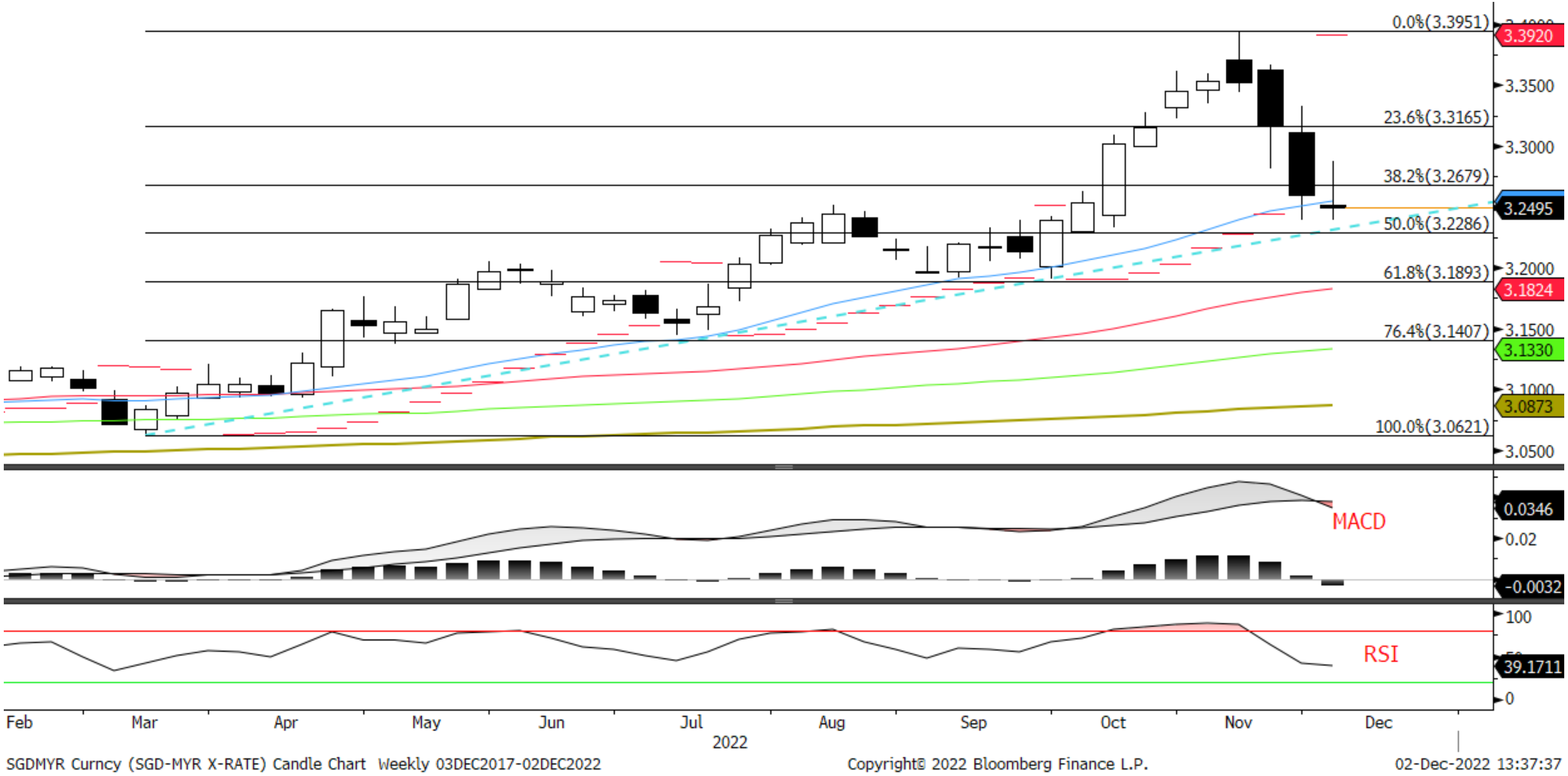
Source: Bloomberg, OCBC

SGDMYR – Bearish Bias though Pace of Decline May Moderate



Source: Bloomberg, OCBC

IDR – Neutral Outlook

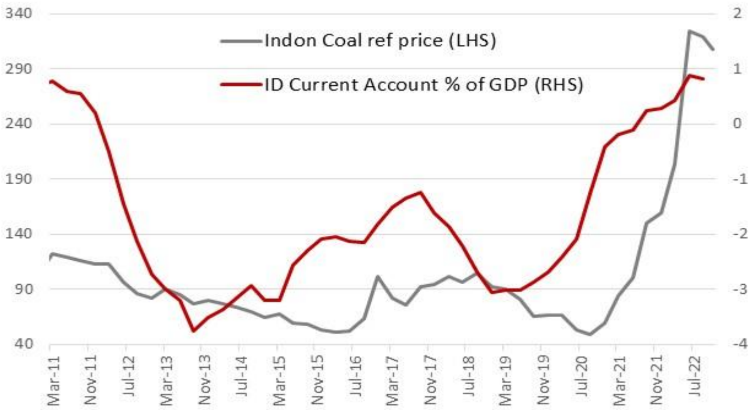
Room for IDR to Appreciate if Foreign Bond Inflows Can Be Sustained

There are positives: 1/ Domestic growth is resilient, supported by strength in private consumption 2/ yield advantage over US as BI keeps up with tightening; 3/ room for IDR gains if foreign bond inflows can sustain momentum as foreign positioning not crowded

But potential deterioration in current account outlook (as exports slow and commodity prices, including coal start to ease) may offset the positives

Room for IDR to appreciate if foreign bond inflows can be sustained

But potential deterioration in current account amid turn in coal prices may undermine IDR



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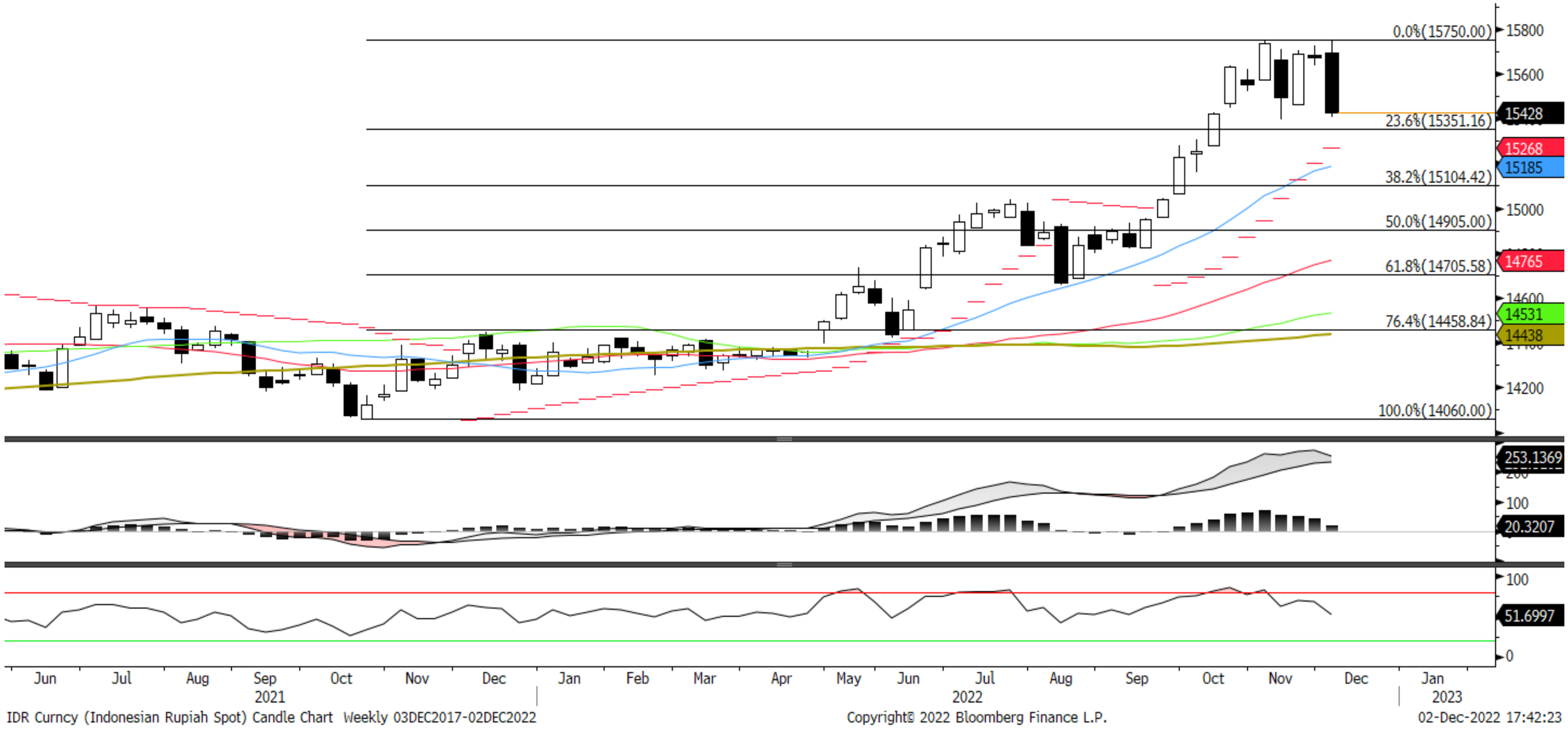
Source: Bloomberg, CEIC. OCBC

USDIDR – Signs of Fatigue in the Run-Up



Source: Bloomberg, OCBC

Gold – Attractive if Fed Policy Calibration Continues

Can Also Serve as a Hedge against Geopolitical Risks

- Aggressive tightening of monetary policies, rising real yields and USD strength were key factors underpinning gold's decline, especially since Mar-2022
- However tide is turning as Fed shifts into policy calibration mode as inflationary pressures in US moderate. Sustained recovery in gold prices is possible if real yields continue to head lower
- History and stretched gold positioning suggest that gold can rebound when tightening cycle ends

Lower real yields can help gold extend gains

Gold shorts at extreme levels can signal inflection points for gold prices (to head higher

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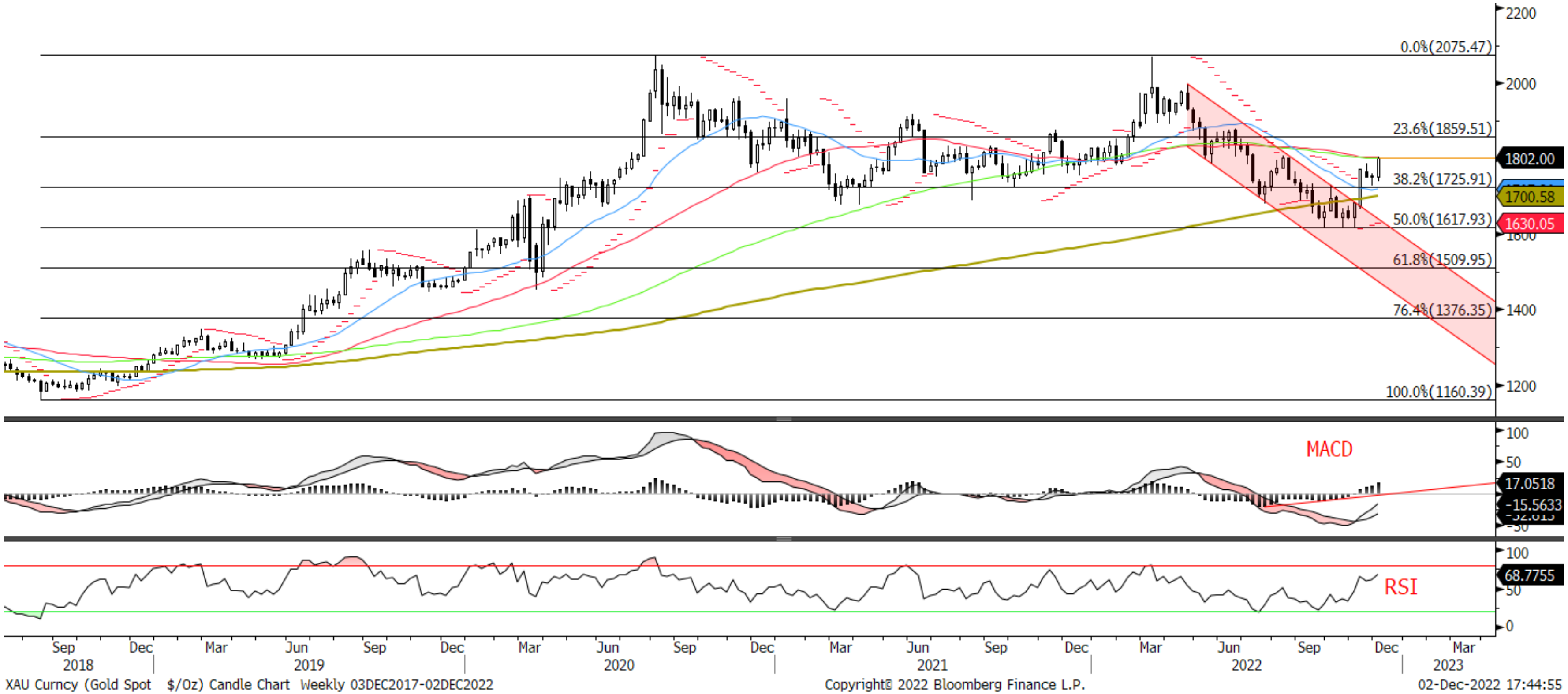
Source: Bloomberg, OCBC

Gold – Favor a Buy on Dips



Source: Bloomberg, OCBC

Thank You

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