OCBC TREASURY RESEARCH

Daily Market Outlook

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FX Themes/Strategy

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- Choppy session for the different asset class overnight, with the big miss on the US ADP employment print first reeling the markets, before a hawkish Clarida compelled a retracement and some more. The 10y UST yield settled 1.0 bp firmer, after an almost 10 bps swing. US equities were mostly weaker. The **FX Sentiment Index (FXSI)** stays little changed within the Risk-Neutral zone.

- The FX space traded in a choppy fashion. The **DXY index** touched low at 91.70 after the ADP print, before reverting to the 92.30 area after Clarida, where it closed. The **EUR** and **JPY** retreated away from their resistances at 1.1900/10 and 108.80/00 respectively. The **AUD** also eased off after touching a high at 0.7420. The biggest mover is the **NZD**, where better than expected labour market data convinced the market than the extended rate hike expectations at the RBNZ is not completely misplaced. 3 hikes priced in at the RBNZ by end of the year is almost certainly an overshoot, but an Aug hike is likely on the cards, and maybe a second one before the year is out. RBNZ remains well ahead of the rest of the other major central banks.

- Clarida and Daly (both voters) signalled that the Fed is on course to announce tapering by this year. Clarida further added that conditions for rate hikes may be in place by end-2022, putting the first hike in early 2023. This is a hawkish surprise, given that Clarida is usually seen as the next highest ranking dove alongside Powell. Together with the ADP miss, this made for a volatile session for the Eurodollar futures. Rate hike expectations closed firmer than it was 24-hours ago.

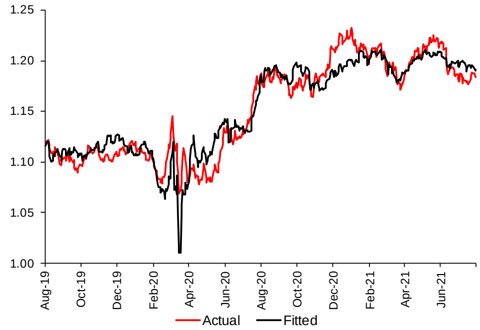
- Comments from Clarida allowed the market to quickly overlook the ADP disappointment. Expect the broad USD to be supported into NFP on Friday. Next event risk will be the BOE meeting later today (1100 GMT). The GBP will need the BOE to turn decidedly less dovish for it to breach 1.4000.

- **USD-Asia:** The BOT held interest rates unchanged as expected, but downgraded growth outlook to 0.80% yoy. Two dissents in favour of a cut suggest that upcoming meetings may be live. On net, this adds further negative pressure on the THB. Note increased buying momentum after the previous resistance at 33.05 is breached. Expect the 33.20/50 range to be the next target.

- **USD-SGD:** The SGD continues to outperform peers, with the NEER edging higher to stand at +0.67% above the perceived parity (1.3600) this morning. For the USD-SGD, the rebound above 1.3500 leaves the support intact. See immediate range between 1.3500 and 1.3550.

EUR-USD

Turning heavy again. The EUR-USD traversed the entire 1.1840 to 1.1900 range that we highlighted yesterday, and closed near the low. Early Thu saw the pair ease south of 1.1840. Immediate target may be pointed southward towards the 1.1800 handle again ahead of the NFP print.

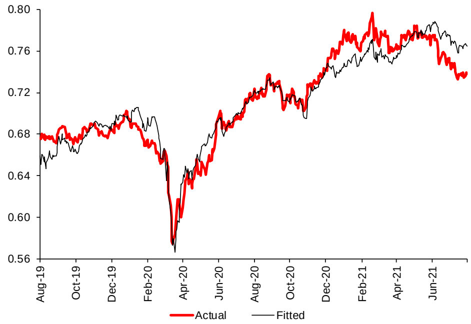


USD-JPY

Heavy. The 10y UST yield closed only marginally firmer amid the volatile session, although the firmer Fed rate hike expectations could see the pair more supported. However, the bounce has yet to materially turn the downside trajectory for now. The pair would likely need to breach the 109.80-110.20 resistance zone for the downside momentum to be reversed. Till then, the 109.00 support is still under the spotlight

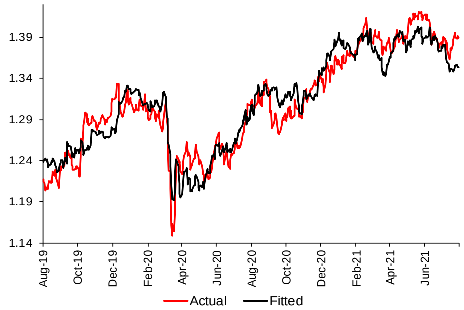
AUD-USD

Consolidate. The AUD-USD moved higher initially on the slipstream of the NZD-USD's aggressive adjustment higher, but this was reversed when USD-buying took hold post-Clarida. Still no clear breach of the the 0.7400 resistance, leaving the pair still sideways. Look instead for further downside in the AUD-NZD cross, on the back of RBA-RBNZ divergence.



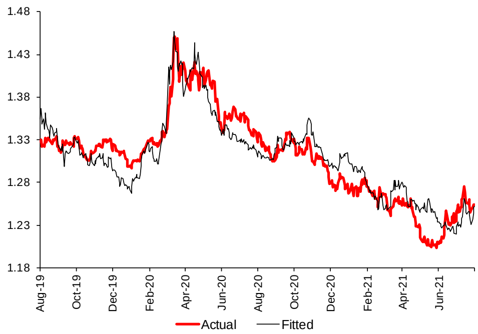
GBP-USD

Headline-driven. The GBP-USD has bounced higher smartly since touching a recent low below 1.3600. However, note that short term implied valuations have not tracked higher in line with spot. To breach the 1.4000 resistance would require more a more sustained catalyst than the reopening and pandemic positives – cue the BOE later today. The support/resistance at 1.3880/1.4000 would likely be unchanged before BOE.



USD-CAD

Keep to downside bias for now. The USD-CAD bounce did not see sufficient altitude to meaningfully challenge the 1.2600 resistance. This leaves the downside bias intact for now, but the still weakening crude complex shall be a negative weight on the CAD.



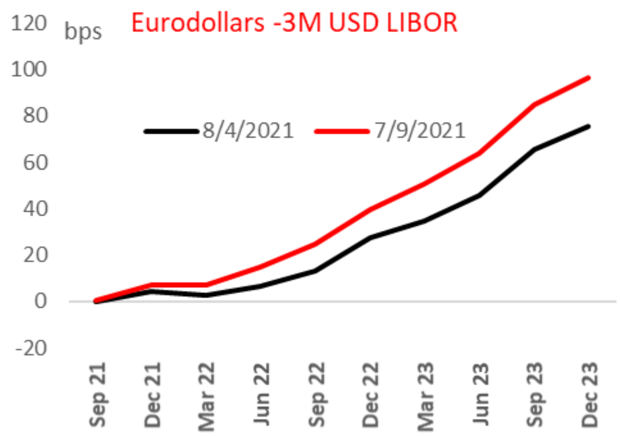
Rates Themes/Strategy

- The intraday rally in USTs on the ADP misses was short-lived, being wiped out by the upbeat ISM services index and more importantly the hawkish remarks from Fed Vice Chair who has been erring on the dovish side. Key resistance for the 10Y bond stays at 1.14%, while the next key level on the upside sits at 1.28%. When the ADP report is not necessarily an accurate predictor of NFP, market focus is apparently on the Friday payroll report for an assessment on how far we are from "substantial further progress".

- Fed Vice Chair Clarida commented that he feels the conditions for raising interest rates could be met by end 2022, and that commencing policy normalization in 2023 would be entirely consistent with the new flexible average inflation targeting framework. These remarks caused some intraday fluctuations in Eurodollar futures as the market had been digesting the soft data earlier. Eurodollar futures now price a rate hike at around the December 2022 contract, versus the September 2022 contract at the hawkish point in early July.

- Treasury's quarterly refunding statement said the department will continue with the current issuance sizes over the next quarter, and expects to make an announcement of reduction in auction size as soon as in November. This timeline is not earlier than expectation and hence did not appear to draw much reaction from the market. As net cash is still being raised from coupon supply, Treasury is to continue with its reduction in bills; the 4W and 8W bill auctions tonight are likely to draw strong bids again with yields expected to be capped at/below 5bp.

- Focus from the Bank of England meeting is probably not on the Bank Rate or the Gilt purchase target, but instead on other parameters including the interest rate threshold for a balance sheet roll-off. SONIA futures turned a tad more hawkish running into the MPC meeting.



Source: Bloomberg, OCBC

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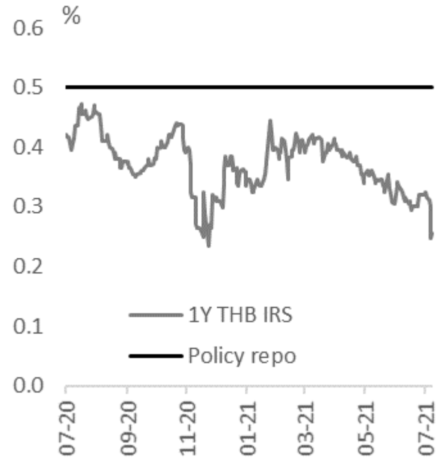
IDR:

IndoGBs were stable caught between profit-taking flows and retail demand. Q2 GDP today is likely to show a strong yoy recovery, partly because of base effect. Market, however, may look past this Q2 report given latest virus development. Likely subdued loan demand alongside the growth prospect may support liquidity going into bonds. The stable USD/IDR also appears to set a favourable backdrop for bond investment. Counteracted by profit-taking flows, yields may however trade in ranges near-term.

THB:

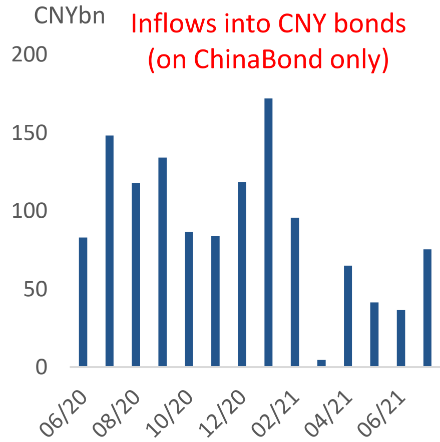
BoT's decision to keep rate on hold yesterday was not unanimous, at a 6-2 vote with two dissidents voting for a 25bp rate cut. Front-end THB IRS fell by 3-6bp in response. Past pattern suggests dovish dissenting vote of two to three has been a precursor to a policy rate cut either at the subsequent meeting or the second meeting after. Indeed, the BoT sounded bearish on growth. 2021 GDP forecast has been revised further lower to 0.7% (versus Finance Ministry's forecast of 1.3%) from 1.8%; 2022 GDP forecast to 3.7% from 3.9%. Even with these downgrades, the central bank views risks to the economic outlook remain high. The 1Y IRS has been for most of the time below the policy rate; during dovish period it had been as much as 40bp below, versus 25bp currently. Front-end THB rates shall remain well anchored.



Source: Bloomberg, OCBC

CNY / CNH:

Foreign bond inflows quickened to CNY75.4bn (on Chinabond only) in July, with CGBs witnessing a bigger increase, followed by PFBs as usual. CGBs provide diversification benefits, while there was also the RRR cut in the month which had supported the bond market sentiment. Looking ahead, we reckon active allocation is needed to sustain the momentum, as upcoming index-induced passive flows may be more paced out than during the previous round of inclusion. Real yield differentials over USTs stay near the upper-end of 5-year ranges, which shall sustain foreign demand barring unexpected volatility in the RMB. Yields, however, are unlikely to fall further meaningfully. While liquidity injections via RRR/targeted RRR cuts cannot be ruled out, MLF maturity and supply are on the heavy side. On balance, the 10Y CGB shall face resistance at 2.75%, and most likely trade in a yield range of 2.8-3.0% on a multi-week horizon.



Source: CEIC, OCBC

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