OCBC TREASURY RESEARCH

Daily Market Outlook

16 September 2021

FX Themes/Strategy

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- Overnight market movements leaned risk-on, with US equities bouncing higher and the 10y UST yield reversing higher intraday to settle around the 1.30% handle. Crude oil surged on supply-related concerns. The **FX Sentiment Index (FXSI)** leaned lower within the Risk-Neutral zone, after 3-4 sessions of moving higher towards Risk-Off.

- The **USD** is broadly lower across the board, but not quite in the usual risk-on fashion. The greenback was softer even against the **JPY**. USD-JPY lost support at 109.50 amid short-covering of JPY-shorts. Note that JPY-shorts have been steadily building since Feb-Mar period, and now stands 0.50 to 0.70 standard deviations above the mean. Overall, USD-JPY implieds in the 3- and 6-month horizon is higher, but there is no outsized spikes. However, there is still room for more JPY-shorts to fold, a process that could accelerate should 109.00/10 levels are breached by end of the week.

- The CAD outperformed on crude oil gains, with the USD-CAD heavy within range. The GBP may be worth another look. The UK saw some strong data releases in the labour market and CPI that has reinforced hawkish BOE rhetoric and added to implied probabilities for BOE rate hikes. The lift-off rate hike is fully priced by May 2022, and another by end-2022. The GBP-USD has not reacted higher, but should these expectations continue to be entrenched, the GBP-USD downside should be limited going forward.

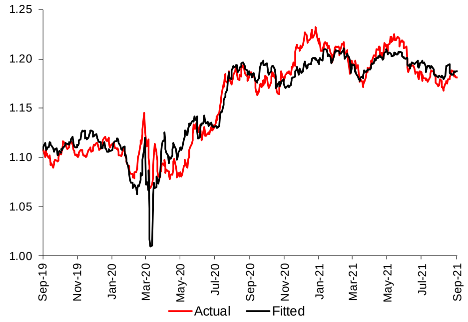
- Overall, USD-centric drivers are quite diffused at the moment, leaving the DXY index sideways. There is room, though, for the different major pairs to diverge on domestic drivers. On balance, we are negative on the AUD and EUR, but is now starting to see scope for JPY and GBP gains against the greenback.

- **USD-Asia**: The RMB advanced to month-lows in USD-CNY and USD-CNH despite soft data releases on Wed. The subsequent bounce higher was lacking in altitude, leaving a rather negative technical picture for the pairs. The bias is clearly to the downside for now, with an approach towards 6.4000 not ruled out. Prefer to sell on rallies in the USD-CNH. Expect this to keep a lid of the broader USD-Asia pairs.

- **USD-SGD:** The SGD NEER stands at +1.12% above the perceived parity (1.3558) this morning, with the +1.20% level a key resistance. 1.3400 on the USD-SGD remains still intact. Preference to buy dips towards the 1.3400 support stays, but any bounce seems very limited in altitude.

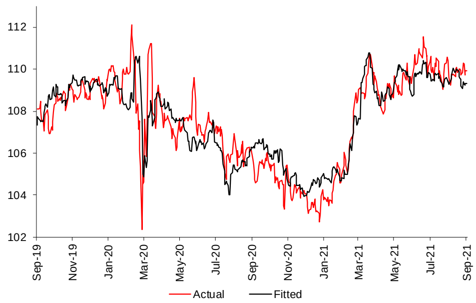
EUR-USD

Biased south. The ECB's Lane sought to dissociate asset purchase volumes to monetary policy stance – a rather curious ask since asset purchases has been the main tool of central banks for some time. The EUR-USD fluctuated within a narrow range just north of 1.1800, but technicals still lean towards downside risks.



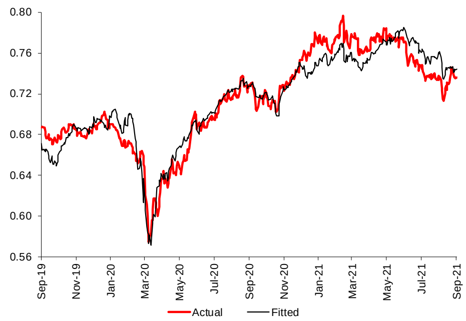
USD-JPY

Downside growing. The USD-JPY breached the 109.50 range low and tested 109.00 support amid some covering in JPY-shorts and soggy action in back-end UST yields. The options space still suggest no imminent risk of a large downside break, but this could change should the next support at 108.80/00 is taken out by end of the week.



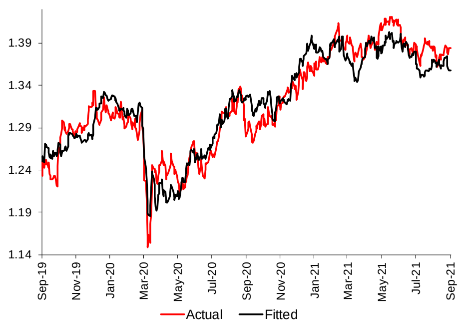
AUD-USD

Southbound. The AUD-USD bounced off the 0.7300 support, but the technicals remain pointed lower for the pair. Our bias remains for it to be lower towards the 0.7230/50 levels on a multi-session horizon. AUD-NZD downside also likely forthcoming, with RBNZ rate hike expectations firming further on firm 2Q GDP data.



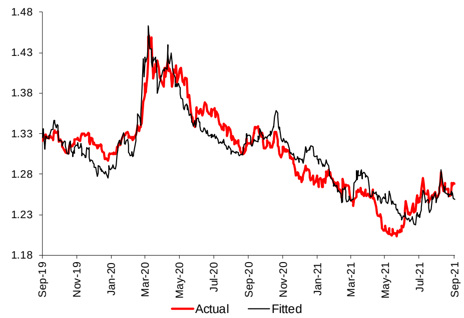
GBP-USD

Sideways. Aug inflation prints ran hotter than expected on Wed, adding fuel to the already higher BOE Feb 2022 rate hike expectations. Should these expectations crystallise into the base case, the GBP may turn supported into the year-end.



USD-CAD

Sideways. Further supply-side jitters emerged to take the crude complex another leg higher, and indirectly imparted some downside pressure on the USD-CAD. Sideways posture for now, bookended by 1.2600 and 1.2700.

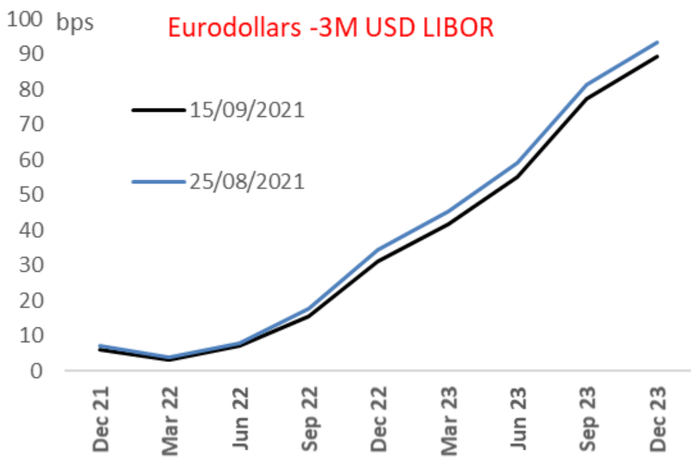


Rates Themes/Strategy

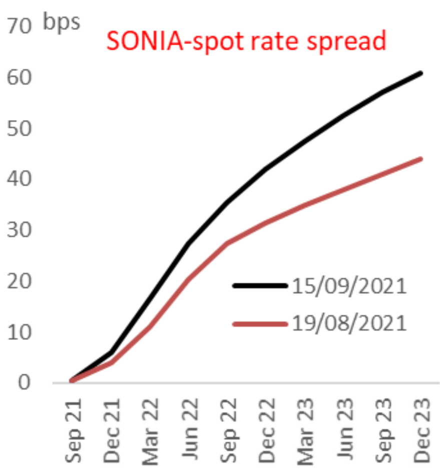
- UST yields edged up on Wednesday in a mildly risk-on trading session, without major catalyst for a directional move. USTs may continue with range-trading in the coming sessions, with the 10Y nominal yield in a range of 1.25% - 1.35%. For the upcoming September FOMC, apart from the taper plan, investors also watch where the next dot-plot is. The slowing m/m CPI inflation supports the notion that inflation pressure is temporary and that the Fed is in no rush to hike rates after taper is completed – but this shall be the consensus already and market is unlikely to react much if the median dot is not brought forward to 2022. On the other hand, if the median dot is moved to 2022, then Eurodollar futures may turn more hawkish in line with the tendency to be ahead of the dot-plot.

- Gilts continued to underperform, as investors brace for a potentially hawkish BoE at its MPC meeting next week. At the August meeting, the MPC was evenly split (i.e. 4-4) as to whether there was clear evidence that the economy is eliminating spare capacity and achieving the inflation target sustainably ("the conditions"). Market watch if the incoming Chief Economist will tilt this split to the hawkish side. SONIA pricing also turned more hawkish, pricing in two rate hikes (one 15bps and another 25bps) by December 2022. The next support for the 10Y Gilt is at 83/84bp.

- The PBoC announced Southbound Bond Connect is to be launched on 24 September. Preliminary information regarding the arrangement of foreign exchange suggests the potential addition of liquidity to the CNH pool may be less than earlier expected.



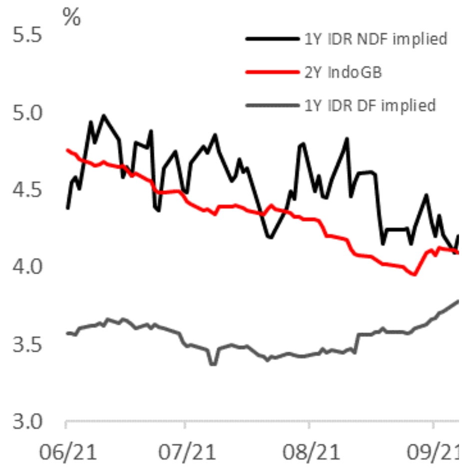
Source: Bloomberg, OCBC



Source: Bloomberg, OCBC

IDR:

IndoGB yields were stable to a tad softer on Wednesday. Supportive factors for the domestic bonds are still around - supply continues to be on the light side, while the Rupiah is likely to stay stable supported by near-term inflows into IDR assets and the trade surplus. Indonesia registered a whopping USD4.74trn of trade surplus in August, a record high and beating consensus by a wide margin. We remain of the view that IndoGBs shall outperform USTs in a rising yield environment – but not an extended downtrend in the absolute yield levels.



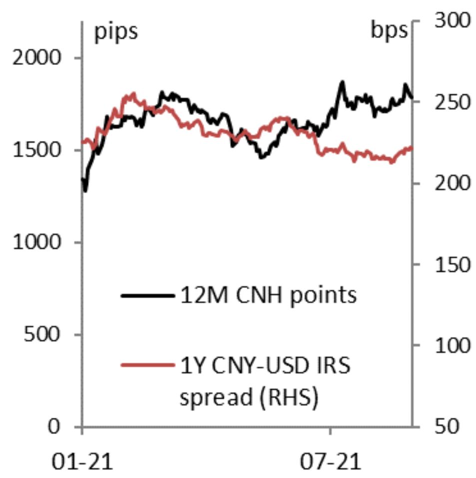
Source: Bloomberg, OCBC

MYR:

Long-end MGS recouped some losses on Wednesday taking cue from the global market. It does not mark a reversal of the gradual steepening bias in the MGS curve in our view. While bond supply so far has proved manageable and there is probably limited ammunition for fiscal policy even upon a higher debt ceiling, investors are likely to stay cautious towards duration as there is nevertheless a mild supply risk.

CNY / CNH:

The PBoC announced Southbound Bond Connect is to be launched on 24 September. The annual quota is initially set at RMB500bn while the daily quota is at RMB20bn, which can be adjusted according to market conditions going forward. Preliminary information on the arrangement of foreign exchange for Southbound Bond Connect and Northbound WMC announced recently suggest to us that the potential liquidity addition to the CNH pool is less than initially anticipated.



Source: Bloomberg, OCBC

First, the PBoC said under the Southbound Bond Connect, onshore investors can make the investment in either the RMB or FCY (foreign currency); in case of investing into non-RMB assets, foreign exchange can be made in the interbank market. As such, it appears to us that the exchange is not conducted, or at least not necessarily conducted, in the CNH market. Hence, only investment into offshore RMB assets will bring in extra CNH liquidity. Second, under WMC, HKMA said Northbound investors "can first obtain RMB funds in Hong Kong's offshore market before remitting the funds" to their accounts onshore. It is not entirely certain as to whether offshore exchange is the only channel, but if it is, then all Northbound WMC flows will translate into a tightening in CNH liquidity, as opposed to the arrangement under Stock Connect and Northbound Bond Connect.

While back-end CNH points look to be topping, and they are still elevated compared with CNY-USD rates differentials, investors probably need to be patient in anticipating more aggressive retracement lower.

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