OCBC TREASURY RESEARCH

Daily Market Outlook

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FX Themes/Strategy

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- The faltering of the reflation trade and a more pro-active Fed appears to have introduced jitters into the markets. Measures of volatility across most asset classes have picked up, and expect this to weigh on sentiment. The **FX Sentiment Index (FXSI)** has moved higher towards the Risk-Neutral zone from Risk-On, and this softening of risk sentiment may still have some way to run.

- The post-FOMC **USD** surge persisted on Friday, with the USD broadly firmer across the G-10 space, except against the **JPY**. The **cyclicals** and **GBP** underperformed as a group. Key support levels across major pairs were breached, leaving the USD still biased higher for now. Note however, that with the USD technicals starting to look overbought, the pace of ascent may slow this week.

- Latest **CFTC** data shows that net implied USD positioning did not shift materially for the non-commecial and leveraged accounts. Individual currency basis, short-JPY bets were cut by both groups. Leveraged accounts did well from adding EUR-shorts, while the non-commercial accounts added AUD-shorts. Note that these are pre-FOMC numbers.

- Comments from Bullard (previously one of the most dovish, voter in 2022) about a late-2022 lift off probably gave more credence to the dot plot. Fed rate hike expectations are more decisively priced in (as seen from Eurodollar futures). On a structural perspective, the FOMC may be a key turning for USD prospects this year.

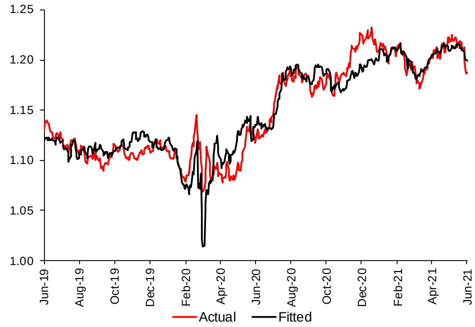
- The softening back-end UST yields leads us to reassess the long USD-JPY view, but firming real yields and the decisive pricing-in of rate hike expectations should still support the USD within the broader G-10 space. In addition, risk-off sentiment from the softening US equities and commodities should add another layer of near-term USD positive. On net, continue to favour the greenback, although the pace of ascent may slow on the back of stretched technicals.

- **USD-Asia:** USD-Asia complex has been largely more resilient than G-10 to the USD's post-FOMC bounce. This is perhaps not surprising, given the propensity for Asian central banks to manage volatility, especially on the weak-LCY side. Expect this parttern to persist. Within Asia, the RMB complex actually outperformed, leaving the CFETS RMB Index back above the key 98.00 resistance. This may not be sustained for long, leaving some potential upside for the USD-CNY and USD-CNH in the near term.

- **USD-SGD:** The SGD NEER eased further, standing at +0.48% above the perceived parity (1.3518) this morning. Look for USD-SGD to firm further, preferring to buy on dips towards 1.3400.

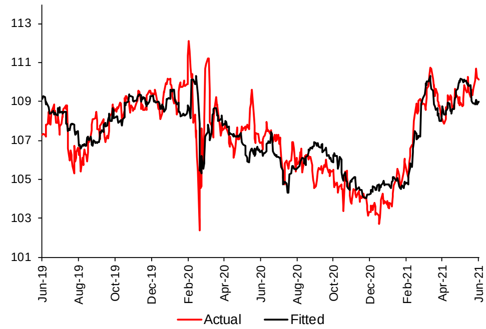
EUR-USD

Heavy. The rapid breach of supports post-FOMC may signal more downside for the EUR-USD. Juxtapose Bullard's late-2022 lift-off against comments from ECB's Lane pushing back against looking at the Sep ECB meeting as a key meeting to reduce monetary support. This should reinforce the divergence between the two, and leave the EUR-USD impinged on a structural basis. 1.1800 and the April low at 1.1704 may be multi-session target for now.



USD-JPY

Laggard amid USD strength. The USD-JPY is only marginally firmer compared to pre-FOMC, and is effectively tracking the back-end UST yield movements. View is that the flattening move has moved too fast too soon, and may retrace soon. This leaves us holding on, for now, to our core long USD-JPY preference, but with a acknowledgement that the JPY may not be leading this round of USD strength.

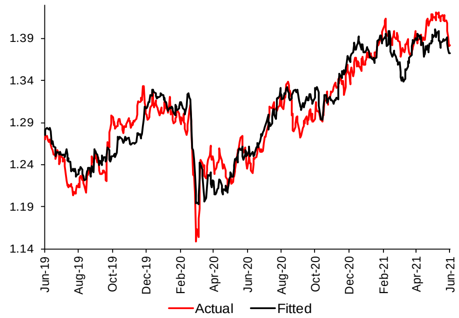


AUD-USD

Heavy. Just as all eyes is set on the FOMC, the labour market down-under posted a blow-out May reading. This led some notable observers to move forward RBA rate hike expectations to early-2023. It remains to be seen if this view catches on more broadly, especially within the RBA itself. Bias for now, however, remains to sell on any bounce, with the pair potentially extending its downside towards 0.7380/00.

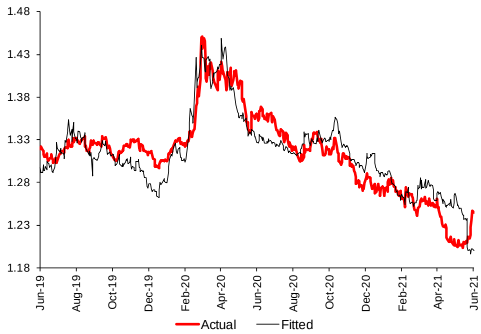
GBP-USD

Heavy for now. The delayed reopening of the UK economy adds to the USD-driven weakness in the GBP-USD. The down-move has eroded the GBP-USD's overvaluation in our short-term implied valuation models. Market attention may refocus to the BOE decision (Thu), which may also show some shift away from the dovish extreme. This should potentially keep the GBP relatively more supported amid USD strength.



USD-CAD

Firmer. The FOMC move floats all boats, with the USD-CAD likely attracted to 1.2500, before 1.2550, on a mult-session horizon. Nevertheless, the CAD retains implicit support from the BOC, and this pair is likely not a preferred expression of USD strength in the longer term.



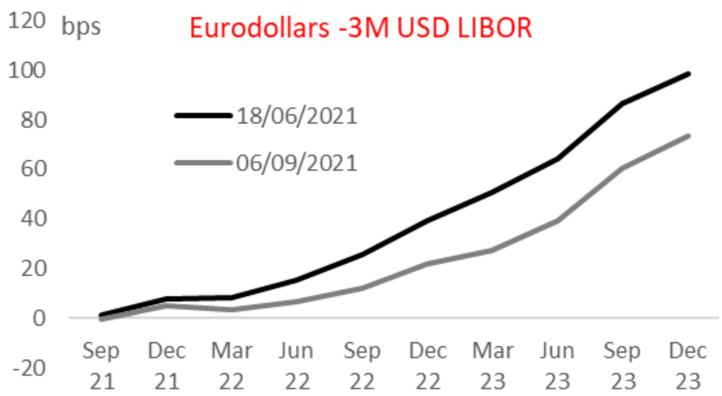
Rates Themes/Strategy

- The UST curve continued to flatten on Friday with the 2Y bond underperforming, upon expectedly sooner rate hikes which may curb inflation following the FOMC and Bullard's hawkish remarks. Breakevens moved further lower with the 10Y breakeven at 2.243%, having retraced by 32bp from the high during mid-May. While the move reflected changing inflation expectation, it also came with higher real yields.

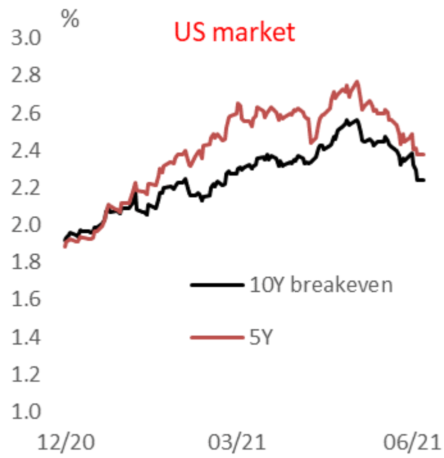
- The flattening move looks a bit excessive. First, Eurodollar futures had earlier adjusted, with rate implied from the March 2023 contract through the December 2023 contract having gone up by almost a full rate hike cumulatively from the low in early June. The adjustment at front-end rates appears done, before the Fed turns yet more hawkish. Second, the start of the rate hiking cycle, albeit being brough forward, is still mostly expected in 2023; the flattening move appears to have come too soon compared with previous cycles, likely a result of previous positioning.

- Driver to the UST market is likely to shift back onto supply, while investors await more details of the tapering plan which may not come soon. This week brings 2Y, 5Y, and 7Y coupon auctions. The 2Y and 5Y have not been the pressure point, and we expect this situation to remain so; a well-received 2Y auction may be able to bring the flattening move to a pause.

- Usage at the Fed's o/n reverse repo was at a still high USD747bn, as the higher RRP rate attracted demand to park funds at the facility. This helps prevent front-end bill yields from falling much further; effective Fed fund rate was higher at 9bp, from 6bp before the hikes in administered rates.



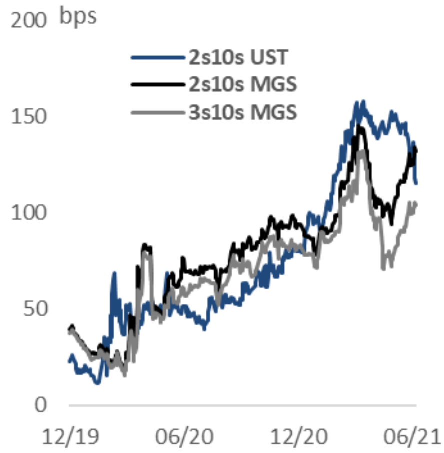
Source: Bloomberg, OCBC



Source: Bloomberg, OCBC

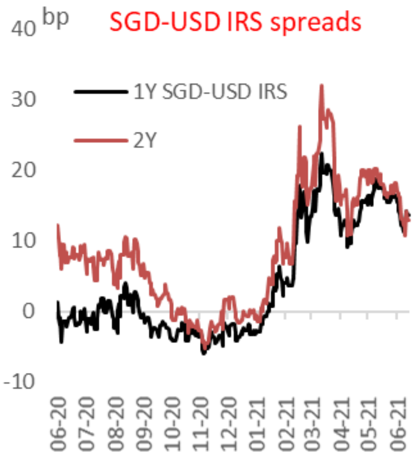
IDR:
The IndoGB curve steepened in the past week despite the flattening move in the UST curve, with most of the buying interest concentrating at the 5Y or shorter tenors. The long end may still face some pressure ahead of supply on Tuesday, which is the first test to demand after FOMC. On balance, with the retracement lower in US long end yields, while USD/IDR continues to be stuck between opposing flows, IndoGBs shall stabilize upon favourable real yield differentials over USTs.

MYR:
MGS generally saw better buying interest on Friday, following the retracement in US yields the night prior. Now the MGS curve is not particularly flat compared with the UST curve, but our bias is still for shorter duration, amid uncertainty over reopening and fiscal support. Nevertheless, the progress on vaccination is reportedly going well with the increase in vaccine supplies.



Source: Bloomberg, OCBC

SGD:
SGS has garnered some buying interest although front-end SGD IRS were paid. The tightness at t/n is seen as temporary; and with front-end USD rates more elevated the compression in front-end SGD-USD rates spreads shall be sustained. Looking further ahead, front-end SGD-USD rates spreads may be able to move towards par when USD liquidity normalise somewhat, upon a resolution of the US debt ceiling, expected by end-July.



Source: Bloomberg, OCBC

CNY / CNH:
The onshore liquidity situation stays mostly neutral, with daily OMO continuing with the CNY10bn pattern, while some NCD rates were reportedly reduced. The 1Y and 5Y LPR were kept unchanged this morning as widely expected. That said, at the mid to long end, investors brace for some pick-up in LGB supply.

In the offshore market, bias to back-end CNH points is neutral to mildly upward, being roughly in line with CNY-USD rates spreads but with minimal addition to the CNH liquidity pool. The swap point curve shape, meanwhile, depends on rolling flows.

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