OCBC TREASURY RESEARCH

Daily Market Outlook

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Frances Cheung, CFA
Rates Strategist
+65 6530 5949
FrancesCheung@ocbc.com

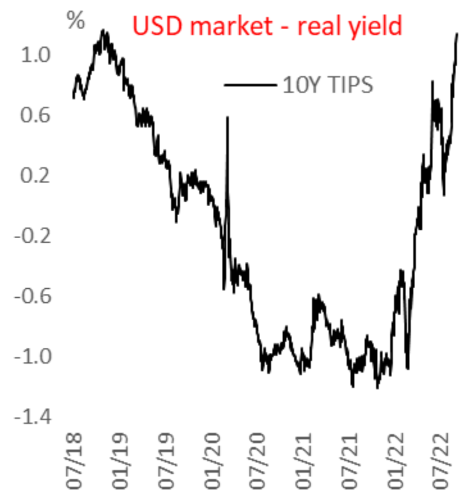
Christopher Wong
FX Strategist
+65 6530 4367
christopherwong@ocbc.com

Treasury Research
Tel: 6530-8384

- The **UST** curve bearish flattened overnight, with the 2Y yield ending the NY session 7bp higher having already retraced from intra-day high. The 10Y real yield rose to 1.13% which was near the pre-Covid peak of 1.16%; valuation looks a bit stretched there. As inflation expectation edged lower there might be a small room for an uptick but that shall be limited to a few bp. Net-net there is limited upside to the 10Y nominal yield before the FOMC outcome. USD OIS mostly expect a 75bp hike at this week's FOMC meeting, with a less than 20% chance seen for a 100bp hike; terminal rate is priced slightly higher at 4.7%. Fed funds futures still price 42bp of rate cuts in 2023 from the expected peak.

- Two things to watch on the dot-plot. The median dot for 2023 was 3.75% (corresponding to a range of 3.625-3.875%) at the last update; the bar is not high for the peak Fed funds rate to be plotted at 4.00-4.25% - i.e. the median dot to be pushed to 4.125%, an outcome which may well be seen as not hawkish enough by the market although our core scenario is precisely for the Fed funds rate to peak at 4.00-4.25%. The longer-term rate – the "neutral rate" – was last at 2.5% which is generally seen as an underestimate.

- **DXY. Slight Risk to Downside but Likely Remain Supported on Dips.** DXY's attempt to test higher yesterday failed as late rebound in equity eased USD strength. We stick to our view that DXY is largely trapped in a holding range ahead of key event risk - FOMC on Thu (2am SG time) as markets await clarity on Fed policy decision. Importantly will Fed hike 75bps or 100bps at the upcoming FOMC and what the dots plot guidance will show in terms of rate hike trajectory for this year and terminal rate. 30d Fed fund futures are still showing that rates could rise towards 4.2% by Dec-2022 and for terminal rate at close to 4.5% by Mar-2023. A hawkish Fed is now the base line scenario, we caution that a Fed that is perceived as less hawkish could see DXY ease lower post-decision. DXY was last at 109.50 levels. Mild bearish momentum on daily chart intact while RSI shows signs of turning lower. Consolidative trades with risks slightly skewed to the downside but we opined that caution may still keep USD dips supported. Support at 109.3 (21 DMA), 108.45 (38.2% fibo retracement of Aug low to Sep high) and 107.70 levels (50 DMA, 50% fibo). Resistance at 110.3 before 110.78 (previous high). Building permits, housing starts data due later today.



Source: Bloomberg, OCBC

- **ECB**. We heard from a few ECB Governing Council members overnight. De Cos, a dove, opined that the cut off of Russian gas would lead to a more prolonged and intense inflation, but also said monetary policy would affect inflation with a time lag of as long as two years and it might be undesirable to force rapid convergence to the 2% (inflation) target. His opinions were somewhat balanced but considering that he is largely seen as a dove then the overnight comments seem to have a hawkish tilt. Vice Governor Guindos, a mild hawk, commented that the central bank has not yet discussed when and how to reduce balance sheet; has not discussed the exact neutral rate; has required instruments to fight fragmentation. Our view has been that QT discussion may not be forthcoming when the need is to get prepared to buy peripherical bonds depending on market conditions and the transmission of monetary policy.

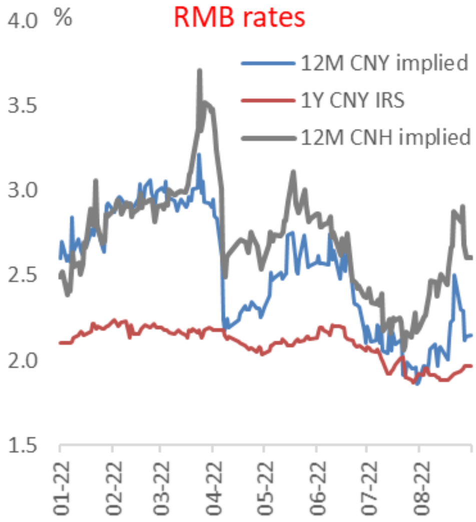
- **EURUSD. Sideways.** EUR drifted modestly higher but with moves still largely trading in subdued range ahead of US event risk. Pair was last at 1.0030 levels. Mild bullish momentum on daily chart intact while RSI is showing signs of rising. Slight risks to the upside but consolidative price action is expected. Support at 0.9960, 0.9910 levels. Resistance at 1.0060 (38.2% fibo). Looking on, we expect EUR to still take cues from (1) ECB speaks; (2) natural gas prices and how recent EU's 5-point plan to tackle energy crisis pans out; (3) Russian-Ukraine conflict, given Putin's warning that war can get more serious and; (4) USD direction and FOMC policy decision. To a smaller extent, we also keep in view Italy general election (Sunday). Opinion polls suggest that a right-wing coalition led by leader Meloni is expected to win. A negative surprise outcome would undermine EUR but it appears political uncertainty in Italy is relatively contained for now. On energy situation, we continue to monitor the outcome on the 5-point plan. A swift move to firm up on the proposals on price cap for gas imports and windfall levy could help to ease price pressures and provide further support for EUR. This week, there are more ECB speaks lined up, including Muller on Tue; Lagarde, Guindos on Wed; Schnabel on Thu and Kazaks, Nagel on Fri.

- **MGS** faced selling pressure across the curve on Monday taking cue from the global market. MGS yields up by 2-5bp shall be considered reflecting the resilience of the domestic bonds; IRS got more paying interest with bond/swap spreads turning more negative which is not unusual. The 3Y MGS yield is still trading in our expected range of 3.3-3.5%. MYR IRS is pricing in around 36bp of hike on a 3-month horizon, which looks hawkish enough but paying interest may be sustained inspired by the global hawkishness. Malaysia's August trade data are due out later today; a trade surplus is expected although unlikely to be particularly large due to expectedly strong imports. More importantly, the CPI to be released on Friday may tilt the balance for expectation at the November MPC meeting.

- **Back-end CNH points** fell overnight on higher US yield. The gap between the offshore DF and the onshore curve stayed wide, at 330pips at the 12M. Or, in implied term, the 12M implied CNH rate was at 2.61%, 12M implied CNY rate at 2.14% and 1Y repo CNY IRS at 1.97% this morning. The lower onshore curve and CNY-USD rates differentials shall continue to exert downward pressure on back-end

CNH points; that said, we are mindful of potential outright positioning near-term. On balance, the strategy remains as sell-on-rally at the back end. Front-end stayed well anchored sustaining the flattening bias of the swap point curve.

- **CNY rates**. The 1Y and 5Y LPR were unchanged this morning, which did not come as a surprise as the MLF rate was also kept unchanged earlier though the lower deposit rates could have argued for some downside room for LPR which reflect banks' overall funding costs. CNY IRS tend not to get ahead of the curve given the uncertainties on the policy rate front. As such, we continue to expect range-trading before the materialization of the next policy action. On OMOs, the PBoC net injected CNY24bn of liquidity this morning via 14-day reverse repos; this is in line with our expectation that more 14-day money may be granted to cover quarter-end and the October holidays.



Source: Bloomberg, OCBC

- **USD/SGD. Consolidate.** USDSGD was last at 1.4075 levels. Mild bullish momentum on daily chart intact while RSI slipped. Potential bearish divergence on MACD is emerging. Bias to sell rallies. Resistance here at 1.4090, 1.4110 levels (double, triple-top resistance). Support at 1.4010 (21 DMA), 1.3920 (50DMA). S$NEER is trading ~1.45% above mid-point.

Treasury Research & Strategy

Macro Research

Selena Ling
Head of Strategy & Research
LingSSSelena@ocbc.com

Tommy Xie Dongming
Head of Greater China Research
XieD@ocbc.com

Wellian Wiranto
Malaysia & Indonesia
WellianWiranto@ocbc.com

Keung Ching (Cindy)
Hong Kong & Macau
cindyckeung@ocbcwh.com

Herbert Wong
Hong Kong & Macau
herberthtwong@ocbcwh.com

Ong Shu Yi
Environmental, Social & Governance (ESG)
ShuyiOng1@ocbc.com

FX/Rates Strategy

Frances Cheung
Rates Strategist
FrancesCheung@ocbc.com

Christopher Wong
FX Strategist
christopherwong@ocbc.com

Credit Research

Andrew Wong
Credit Research Analyst
WongVKAM@ocbc.com

Ezien Hoo
Credit Research Analyst
EzienHoo@ocbc.com

Wong Hong Wei
Credit Research Analyst
WongHongWei@ocbc.com