OCBC TREASURY RESEARCH

Daily Market Outlook

21 September 2022

Bar is high for the Fed to out-hawk

- **UST** yields moved further higher ahead of FOMC decision, while Fed funds future/OIS pricings were little changed mostly expecting a 75bp hike. The cumulative increase in the 10Y yield since the low on 1 August was entirely driven by higher real yield, while breakeven edged down. We remain of the view that the 10Y UST yield faces resistance to the upside near-term especially before more data underpinning the strength of the US economy come in. 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; it does not require a lot of shifts to push the 2023 median dot to 4.125% (corresponding to a range of 4.00-4.25%), 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.

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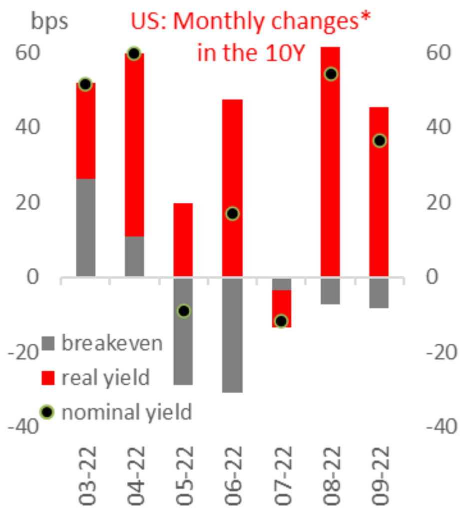
- **DXY. Well Bid ahead of FOMC (2am SG time).** USD is trading firm ahead of FOMC decision. Markets will be keeping a lookout on quite a few things including (1) the size of hike - whether its 75bps or 100bps; (2) the dots plot for guidance on where the fed fund target rate is headed to as well as (3) Powell's testimony for any shift in tone. 30d Fed fund futures are looking for rates to go up to 4.2% by Dec-2022 and as high as 4.5% by Mar-2023. A scenario where the Fed manages to out-hawk market expectations via its dots plot could see USD challenging fresh highs. Importantly the dots plot will also shed light if Fed officials are looking for any chance of rate cut or higher rates to throughout 2023 since the dots are plotted for year-end instead of quarter-end. Alternatively, if the Fed outcome turns out to be less hawkish than anticipated, the USD could see a corrective pullback. DXY was last at 110.25 levels. Daily momentum and RSI indicators are not showing a clear bias for now. Consolidative trades likely ahead of event risk. Support at 109.4 (21 DMA), 108.45 (38.2% fibo retracement of Aug low to Sep high) and 107.70 levels (% fibo). Resistance here at 110.3 before 110.78 (previous high) and 112 levels.



Source: Bloomberg, OCBC
*as of 20 September

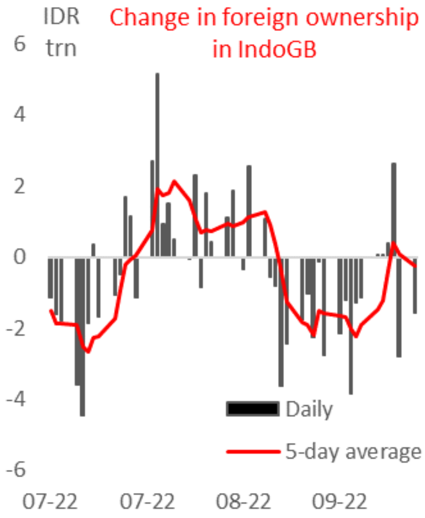
- **EURUSD. Slippages.** EUR slipped amid USD rebound and Russian escalation to annex the 4 regions in Ukraine – Luhansk, Kherson, Donetsk and Zaporizhzhia. Referendums are planned in these 4 Russian-occupied Ukrainian regions on whether to join Russia in coming days. Pair was last at 0.9965 levels. Mild bullish momentum on daily chart faded while RSI shows signs of turning lower. Risks to the downside but consolidative price action is expected. Support here 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.

- **GBPUSD. Cautious; Nearing Key Support.** GBP continued to trade with a heavy bias. Last at 1.1375 levels. Daily momentum shows tentative signs of turning bearish while RSI fell. Risks are skewed to the downside. Immediate key support at 1.1351 (recent low). Break below this puts next support at 1.10, 1.0545 (1985 low). Resistance at 1.18 levels. Sell rallies preferred. This week, the focus is on BoE MPC decision on Thu while emergency mini budget will be closely scrutinised on Fri. The risks of further inflation upticks, energy price increases and potentially a large fiscal stimulus package have led markets to price in higher interest rates. OIS-implied now suggests that markets are nearly evenly split between 50bps and 75bps hike and for rate to go much higher from current levels to end-cycle peak of 4.6% by Jun-2023. Our base case is for 50bps hike at the upcoming MPC but a jumbo 75bps hike should not be ruled out, given BoE's priority to curb inflation. A case of larger than expected hike may provide some support for the GBP but we opined any gains may well be temporary as the weak UK economy may not be able to withstand overly restrictive policy. Markets will also eye BoE's QT plans. Any delay in prior decision could undermine GBP. Elsewhere Chancellor Kwarteng will deliver emergency mini budget on Fri, which could include GBP30bn of tax cuts while Truss's plan to cap energy cost at GBP2,500 per year for 2 years could cost between GBP100bn to GBP200bn. Public borrowing is projected to be at least GBP100bn. More details will come on Fri. We are cautious of how sovereign risk rating may be affected.

- **USDJPY. Fed and BoJ Event Risks.** USDJPY firmed, tracking broad USD, UST yield move higher. USDJPY was last at 143.70 levels. Bullish momentum on daily chart is fading while RSI eased. Risks remained skewed modestly skewed to the downside. Support at 142.50, 141.5 levels (23.6% fibo retracement of Jul low to Sep high). Resistance at 143.70, 145 levels. While markets may not be convinced of a BoJ intervention, we cautioned against complacency as warnings from Japan officials are growing louder. Any sharp, excessive move beyond 145 – 146 levels could possibly spark off actual intervention again though question remains how sustainable it can be if there is no follow through in BoJ policy and that USD and UST yield momentum continues to head north. That said, markets are likely to watch for any complementary responses from BoJ. Our base case is for BoJ to stand pat though we do not rule out the risks of possible tweaks at some point. A few options that the BoJ may consider is: (1) exit negative policy rate; (2) adjust the 10y JGB yield target higher; and/or (3) raise the upper bound of the YCC cap of 0.25%. Any of this policy tweaks can potentially help to slow JPY's depreciation.

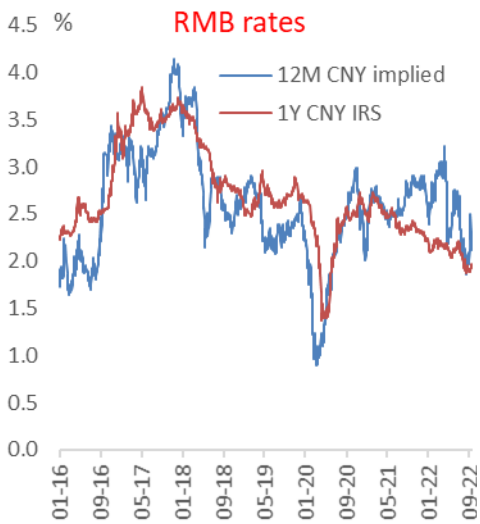
- **MGS** continued to face selling pressure across the curve on Tuesday as investors prepared for FOMC, while domestically strong trade numbers might have added marginally to BNM rate hike expectation. Malaysia imports increased by 67.6% YoY driven by petroleum products, and electrical and electronics products; by stage of production, most imports were intermediate goods which bodes well for exports in the coming months. The CPI to be released on Friday will be more important in driving tightening expectation. MYR rates are pricing in around 34bp of hike on a 3-month horizon, which looks fair. Some consolidation in the MYR basis was seen probably as market pared back expectation for a 100bp Fed rate hike.

- **IndoGBs** traded mixed on Tuesday with some interest seen at the 10Y (FR91). IDR6.27trn of bonds were awarded at the sukuk auction, below the indicative target of IDR9trn. The award ratio was particularly low for the 2034 bond (PBS029); it might be that most incoming bids were near the highest incoming yield of 7.39% which was seen as too high, while there might be a preference for/to allocate more to the new 7Y bond (PBSG001). YTD fund raising amounted to around IDR750trn including auctions, private placement and book-building, roughly on track with full year requirement. Bank Indonesia is widely expected to hike its policy 7-day reverse repo rate by 25bp on Thursday, an outcome which shall lead to muted market reaction. The IndoGB curve shall stay flat on rate hike and operation twist. Inflows into IndoGBs have not been sustained as US yields have been rising relentlessly. After two days of relatively big outflows, foreign holdings of IndoGBs fell to IDR745.8trn, or 14.84% of outstanding, as of 19 September.



Source: Bloomberg, OCBC

- **Back-end CNH points** fell overnight on higher US yield. The gap between the offshore DF and the onshore curve stayed wide, at 327pips at the 12M. Or, in implied term, the 12M implied CNH rate was at 2.60%, 12M implied CNY rate at 2.14% and 1Y repo CNY IRS at 1.95% this morning. Implied rates are not particularly low compared to repo IRS, while the pressure is generally to the downside for regional basis swaps, i.e. there is room for implied rates to go lower vis-à-vis swap rates. On top of this, 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 and potential reaction to the FOMC outcome – a less-hawkish-than expected outcome would see retracement lower in US yields. Separately, the RMB5bn of offshore PBoC bill auction was well received, garnering a b/c ratio of 4.56x, with cut-off at 2.20% vs 6M implied CNH rate at 2.56%. The issuance represented a roll-over and had limited impact on CNH liquidity.



Source: Bloomberg, OCBC

- **USD/SGD. At Risk of Breaking Double-Top?** USDSGD inched higher, tracking broad USD move higher and RMB weakening to fresh lows vs USD this year. Pair was last at 1.4105 levels. Technical signals are not the most convincing at may even be in conflict. Mild bullish momentum on daily chart intact while RSI rose. But at the same time, potential bearish divergence on MACD may be emerging. We watch price action for further cues. Resistance here at 1.4110/20 levels (double, triple-top resistance). Break-out targets 1.4160 next. Support at 1.4020 (21 DMA), 1.3920 (50DMA). S$NEER is trading ~1.5% above mid-point.

- **USDTWD. Elevated as it Awaits CBC and Fed.** USDTWD continued to maintain altitude near 31.41 levels. Daily momentum is bullish while RSI is very overbought. Upside risks intact but the pair is now at critical juncture given stretched technical and one-way trade. We watch for cues from CBC and Fed for USD direction. For CBC MPC (22 Sep), we expect policymakers to opt for 12.5bps hike to bring policy rate to 1.625% as some sectors of the economy (i.e. tourism, self-employed, etc.) still need support. Ongoing covid/ border restrictions remain a constraint on domestic demand, tourism sectors. Widening of Fed-CBC policy divergence is not the only factor underpinning TWD weakness. Falling export orders amid slump in semiconductor demand and slower demand from China, continued net foreign outflow of local equities, risk of worsening China-Taiwan relations affecting investment flows are some other factors underpinning TWD weakness. Near term resistance here at 31.42, 31.60/70 levels. Support at 30.2.

Source: Bloomberg, OCBC

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