OCBC TREASURY RESEARCH

Daily Market Outlook

22 September 2022

Race to hike

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

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

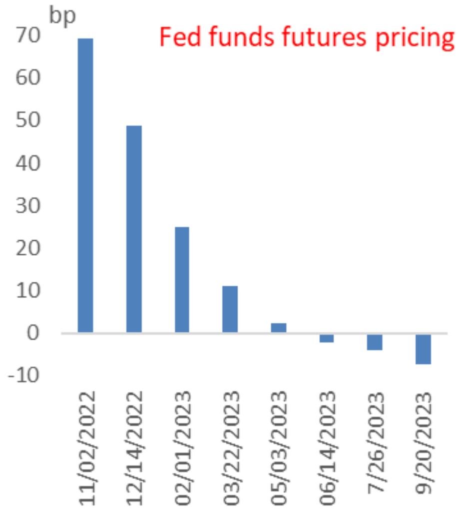
Treasury Research
Tel: 6530-8384

- The **UST** curve pivotal flattened upon the hawkish FOMC outcome, as more aggressive hikes will further hurt growth. Knee-jerk reaction saw the 2Y yield hitting 4.1168% transiently before settling lower to still close the NY session 8bp higher at 4.0484%. The 10Y yield ended 3bp lower as both the breakeven and real yield softened mildly. Now USD OIS/Fed funds futures are pricing in additional hikes of 118bp/119bp by year-end, similar to the 125bp as suggested by the FOMC median dot. Terminal rate is priced at 4.8% versus the 2023 median dot of 4.75% (4.625% corresponds to the Fed funds rate target range of 4.50-4.75%). The disagreement between the market and the dot-plot is that market still prices some rate cuts in 2023, and as such expect a lower Fed funds rate than the dot-plot at end 2023. We remain of the view that rate cuts in 2023 shall be priced out.

- The **FOMC** hiked the Fed funds target rate to 3.00-3.25% as expected. What came as a hawkish surprise was the dot-plot, which now have the 2022 median dot at 4.375% (correspond to a Fed funds target range of 4.25-4.50%), and 2023 median dot at 4.625% (range of 4.50-4.75%). The 2022 median dot points to a likely 75bp-50bp hiking profile for November and December FOMC meetings. And if these were delivered, then the hurdle would not be high for the FOMC to walk the talk and hike the Fed funds target rate to 4.50-4.75% which would require only a 25bp hike in 2023. Note six FOMC members see the Fed funds rate at 4.75-5.00% by end-2023. These expected Fed funds target rates point to further upside to the 2Y UST yield, towards 4.20-4.30% by year-end. The 2Y yield already running ahead of the Fed funds rate, and some safe-haven flows amid geopolitics might have been factors preventing the yield from reacting more to the FOMC outcome earlier.

- **10Y UST yield**. Fed economic projections now have slower growth (1.2% for 2023 versus 1.7% as previously expected) and higher unemployment rate (4.4% for 2023 versus 3.9% prior), precisely reflecting their determination to hike rates despite the pain to the economy these hikes would bring. The more subdued economic outlook shall limit the upside to real yield while the expectedly aggressive rate hikes shall keep long-term inflation expectation better anchored. We expect the 10Y breakeven hover around the recent range of 2.35-2.45% which is near the recent high, while the 10Y real yield to stay around or below 1.16% which is the pre-Covid peak, pointing to a range of 3.5-3.6% for the 10Y nominal yield near-term.

- **DXY. Outperformer.** USD extended its run higher as Fed out-hawks market expectations. Elsewhere the re-escalation in Russian conflict over Ukraine further undermined EUR, GBP as well as other high-beta FX and added to broad USD strength. Summary of economic



Source: Bloomberg, OCBC

Source: Bloomberg, OCBC

projections also pointed to higher core inflation forecast at 4.5% (+0.2ppts) and 3.1% (+0.4ppt) for 2022 and 2023, respectively while unemployment is projected to rise significantly higher to 4.4% (from 3.9% prev) in 2023. Growth projection also saw a substantial revision to the downside for 2022 (+0.2%, down from 1.7% prev). At the press conference, Fed Chair Powell said that chances of a soft landing will likely diminish in pursuit of restoring price stability. On net, the substantial revision in Fed expectations and comments show that Fed officials have shown greater willingness to tighten policy in the face of surging inflation even at the expense of growth. USD strength may persist for longer and at the same time, the recent round of escalation in Russian geopolitical tensions over Ukraine suggests that the conflict could drag on for longer, posing risks to higher inflationary pressures and raises risk of hard-landing. DXY was last at 111.65 levels. Daily momentum turned bullish while RSI rose towards near-overbought conditions. Risks still skewed to the upside. Resistance at 112, 112.40 levels. Support at 110.3, 109.55 (21 DMA).

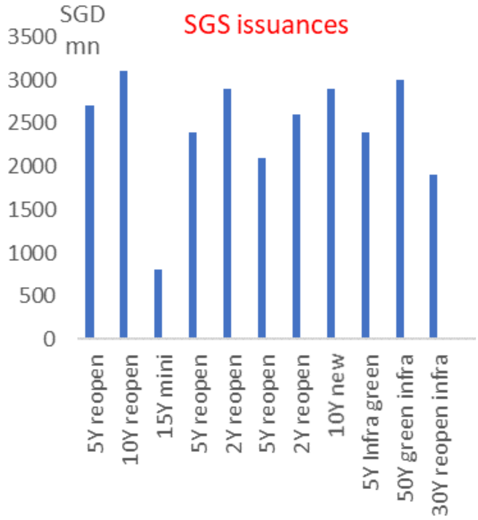
- **EURUSD. Heavy Bias.** EUR fell further, first driven by news of Russian escalation of tensions and into the overnight session, driven by a hawkish Fed (USD strength). Russian Defence minister said that 300,000 reserves will be called up as partial mobilisation while referendums are planned in these 4 Russian-occupied Ukrainian regions of Luhansk, Kherson, Donetsk and Zaporizhzhia on whether to join Russia in coming days. Recent round of escalation in Russian geopolitical tensions over Ukraine suggests that the conflict could drag on for longer, posing risks to higher inflationary pressures and raises risk of hard-landing. EUR and GBP are at risk of further downside pressure in the near term. Pair was last at 0.9815 levels. Daily momentum turned bearish while RSI fell. Risks to the downside. Support at 0.98 if broken could see further downside unravel towards 0.9650, 0.95 levels. Resistance at 0.9910, 0.9980 levels. Looking on, we still 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, if there is further escalation. 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.

- **BoE.** GBP OIS is pricing in a 70% chance of a 75bp hike at today's MPC meeting, while analyst consensus is for a 50bp move. Another focus at today's MPC is the decision on bond selling as part of QT. At the August meeting, the MPC judged that, over the first twelve months of a gilt sales programme starting in September, a reduction in the stock of purchased Gilts held in the APF of around GBP80bn was likely to be appropriate – this shall comprise GBP40bn via run-off and GBP40bn via active selling. MPC members are set to vote on this plan. However, upon the announcement of the energy subsidy plan, Governor Bailey had said the plan to active sell Gilts may be adjusted if they judged that the market might not be able to absorb the subsequent, additional supply of Gilts. Market watch these two parameters – the rate hike itself and the QT decision – for relative hawkishness at the BoE.

- **GBPUSD. BoE MPC in Focus.** GBP continued to trade lower, after breaking past key support at 1.1351 as Russian escalation and hawkish Fed weighs. Last at 1.1235 levels. Daily momentum is turning mild bearish while RSI fell. Risks are skewed to the downside. Next support at 1.10. Previous key support at 1.1351 (recent low) now turns resistance. Sell rallies preferred. This week, the focus is on BoE MPC decision today 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 inching closer 75bps hike (79% probability) and for rate to go much higher from current levels to end-cycle peak of 4.75% 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. BoJ in Focus.** 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. USDJPY drifted higher overnight amid hawkish Fed but weakness trailed other Asian FX as Russian escalation spooked risk aversion flows (partially favouring JPY). Pair was last at 144.50 levels. Bullish momentum on daily chart faded while RSI rose. Risks modestly skewed to the upside. Resistance at 145 levels. Support at 142.50, 141.5 levels (23.6% fibo retracement of Jul low to Sep high). 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.

- **SGS**. The size of the upcoming 30Y SGS (Infra) reopening on 28 September has been announced at SGD1.9bn (with MAS not participating), which is on the low side. This is the last auction of the year, which will bring the full-year gross issuance to SGD26.8bn which is well manageable and in line with the estimated annual growth in outstanding SGS (MD and Infra combined). Absence of supply in Q4 shall add to SGS resilience. Front-end USD/SGD forwards points edged down, reflecting a more comfortable liquidity situation, which also helps mitigate the upward pressure on front-end SGD rates emanating from higher USD rates. The 2Y SGD-USD OIS already hit and passed our initial target of -60bp; we do not expect the spread to widen back near-term.



Source: MAS, OCBC

- **USD/SGD. Breaking Up.** USDSGD rose, tracking USD strength (post-FOMC), continued weakening in RMB and recent escalation in geopolitical tensions (stoking risk-off sentiment). Pair was last at 1.4205 levels. Bullish momentum on daily chart intact while RSI rose. Risks to the upside. Resistance at 4.4295 (76.4% fibo retracement of 2020 high to 2021 low). Support at 1.4160, 1.4110/20 levels. S$NEER is trading ~1.33% above mid-point.

- **USDTWD. CBC Awaits.** For CBC MPC today, 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. USDTWD continued to trade higher amid broad USD strength. Last at 31.58 levels. Daily momentum is bullish while RSI is very overbought. Upside risks intact. Near term resistance at 31.60/70 levels. Support at 31.4.

- **USDPHP. BSP Likely to Dial Down Pace of Hike.** USDPHP continued to trade higher in uncharted territories as hawkish Fed kept USD broadly bid. Pair was last at 58.38 levels. Bullish momentum intact while RSI is in overbought levels. Resistance at 59.2. Support at 58.2, 57.6 levels. Following an off-cycle 75bps hike in Jul, we opined BSP can dial down its pace of hike to 50bps (to bring policy rate to 4.25%) in attempt to address elevated inflation of 6.3% (well above BSP target of 2% - 4% band) and slow rate differential gap with US.

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