OCBC TREASURY RESEARCH

Daily Market Outlook

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Thin Liquidity Exacerbates

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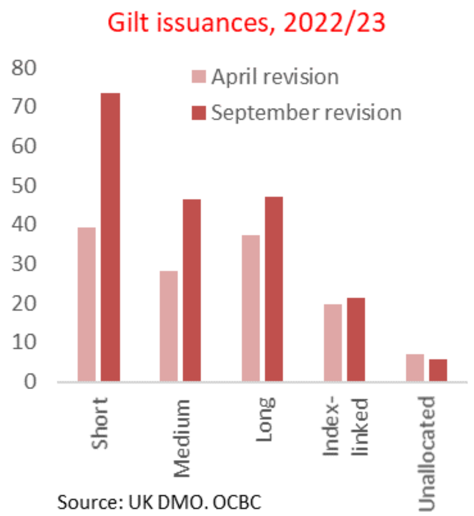
- FX markets had a wild ride this morning, with GBP taking a plunge from just above 1.08 to intra-day low of 1.0350 while most other AxJs, including KRW extended their weakness after RMB fix came in above 7-handle. PBoC has also just imposed a 20% risk reserve requirement (up from zero) on FX forward sales while BoJ ramped up its operations (to buy JPY550bn of JGBs maturing in 5 -10y vs JPY150bn in previous operation). Market volatility remains elevated and we do not rule out further responses from regional policymakers to calm sentiments. Gilts were sold off on Friday upon UK's announcement of the Growth Plan. While being idiosyncratic factors driven, there was some spill-over onto other markets; the UST curve bearish flattened on Friday and the AGB curve bearish flattened this morning as well, though understandably with much milder movements. Treasury and Bund futures fell upon Asia open this morning. USD OIS pricing is little changed, still expecting a 75bp-50bp hiking profile for the remainder of the year.

- **Gilt**. The DMO (Debt Management Office) revise upward net financing requirement by GBP72.4bn, of which GBP62.4bn would be via additional Gilt issuances, and GBP10bn via bill issuances. Most (half) of the additional Gilt issuances will be at the short end (GBP31.2bn), followed by medium tenors (GBP17.5bn). The Gilt yield curve bearish flattened accordingly. The total cost needed to fund the Growth Plan was estimated by the Resolution Foundation at GBP400bn over the next five years. Gilt supply outlook aside, investors brace for the inflationary pressure the Plan may bring, with GBP OIS pricing a total of 189bp of hikes at the November and December MPC meetings – such pricings do not only reflect rate hike expectation but probably hedges to bond positions as well; the 1Y bond/swap spread went to -117bp and 2Y to -121bp. Still, inflation pressure from the Growth Plan and imported inflation from the weak sterling do add to rate hike prospects. Market watch if there is any calm coming to the Gilt market as London opens on Monday; even if there is some stabilization, risk-reward does not justify positioning for Gilt rally at the moment.



Source: UK DMO, OCBC

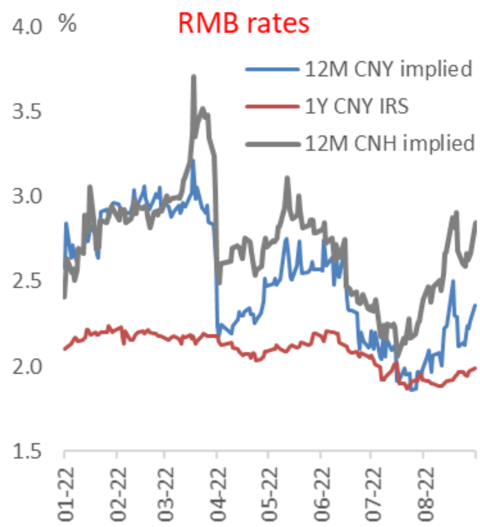
- **USTs**. The 2Y Treasury yield rose further to break above 4.25%. Rates to stay higher 'for some time" shall see the remaining easing expectation in 2023 being gradually pushed to 2024, allowing the 2Y UST yield to adjust further higher to better align with the expected terminal rate. We expect the 2Y UST yield to reach 4.60% by end Q1-2023. 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 therefore expect the 10Y breakeven to hover around the recent range of 2.35-2.55% and the 10Y real yield not to be able to rise much above the current 1.30% level which is already higher than the pre-Covid peak. These point to the 10Y nominal yield being capped at 3.90% on a multi-month horizon.

- **DXY. Haven Demand.** USD dominance reigns supreme, with thin market liquidity exacerbating the moves this morning. US futures extended its decline while most Asian equities are in the red this morning. 2y UST yield topped 4.24%. The toxic combination of tighter financial conditions, persisting USD strength, global growth concerns driven by slowdown in China and Europe, and sustained weakening in RMB past 7 per dollar sets up a challenging stage for pro-cyclical FX, including KRW. We expect the environment of higher UST yields and soggy risk sentiments to keep USD broadly bid. DXY was last at 113.73 levels. Bullish momentum on daily chart intact while RSI rose into overbought conditions. Support at 113.20, 112.40 levels. Resistance at 114.20, 114.50 levels. Day ahead, watch CFNAI, Dallas Fed mfg activity.

- **EURUSD. Bearish but Oversold.** EUR extended its decline this morning following the sharp plunge in GBP. Pair traded as low as 0.9554 before rebounding higher. Last at 0.9660 levels. Bearish momentum on daily chart intact while RSI dips into oversold conditions. We watch if the dip in EUR manages to reverse entirely today. Support at 0.9555 levels (intra-day low). Resistance at 0.97, 0.9865 levels. Elsewhere we also watch if Russia dials up geopolitical tensions again. Referendums are underway on the 4 Russian-occupied Ukrainian regions of Luhansk, Kherson, Donetsk and Zaporizhzhia while partial mobilisation is already underway. These may suggest that the conflict could drag on for longer, posing risks to further inflationary pressures and raises risk of economic hard-landing. 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. Elsewhere on Italy general election, projections from RAI suggested no surprise as the right-wing coalition led by leader Meloni could get 114 seats in the Senate (where 104 is needed for a majority). Her coalition is also projected to control the 400-seat chamber.

- **GBPUSD. Flash Crash.** GBP plunged sharply this morning from above 1.08 to a low of 1.0350. Thin market liquidity likely to have exacerbated the move. To recap, Chancellor Kwarteng's budget entailed a series of unfunded tax cuts and extra spendings. Some measures include (1) the 45% top tier on income tax will be abolished; (2) cap on bankers' bonuses lifted and planned increase in corporate tax abandoned; (3) planned increase in national insurance reversed. Tax cut package costs GBP45bn a year and the move to subsidise energy bills will cost GBP60bn for next 6 months (plan to subsidise household for 2 years). The GILTS market was already under intense sell-off and may not be able to handle more supply from Treasury sales and BoE's QT (to begin active sales of GILTs next month). We also remain cautious on potential downgrade to UK's sovereign rating/ outlook. Our cautious outlook on GBP remains intact. Not only is short GBP a market's favourite trade for stagflation proxy but increasingly, GBP is also facing a confidence issue. GBP was last at 1.0510 levels. Bearish momentum on daily chart intact while RSI is in oversold conditions. Risks remain skewed to the downside. Next support at 1.0350 (low intra-day), parity levels. Resistance at 1.0455, 1.08 levels. Sell rallies preferred.

- **CNH points** rose as China re-imposes the 20% FX risk reserve requirement on FX forward sales. The 20% FX risk reserve requirement would add a few hundred pips to the cost of forward positions which mean a higher effective onshore FX point curve; for example, at a 1Y USD rate of 4% the cost of 12M forward position would be 570pips higher at the current spot level. Against the impact on cost, initial market reaction this morning appeared somewhat mild, probably as the offshore curve was higher than the onshore curve to start with. Still, there is scope for the offshore-onshore gap to widen further to reflect the higher effective onshore curve. In rates terms, the offshore 12M CNH implied rate went up to 2.84% and onshore 12M CNY implied rate to 2.36% at the time of writing; these were against onshore 1Y repo-IRS at 2.00%.



Source: Bloomberg, OCBC

- **USD/SGD. Bullish but Overbought.** USDSGD remains better bid, tracking USD strength amid poor market liquidity conditions this morning while continued weakening in RMB and sell-off in regional equities further weighed on sentiments. Pair was last at 1.4340 levels. Bullish momentum on daily chart intact while RSI rose into overbought conditions. Risks are to the upside. Resistance at 1.4360/70 levels (around intra-day high). Support at 1.4295 (76.4% fibo retracement of 2020 high to 2021 low), 1.4220 levels. S$NEER is trading ~1.4% above mid-point.

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