OCBC TREASURY RESEARCH

Daily Market Outlook

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Rates and FX Themes/Strategy

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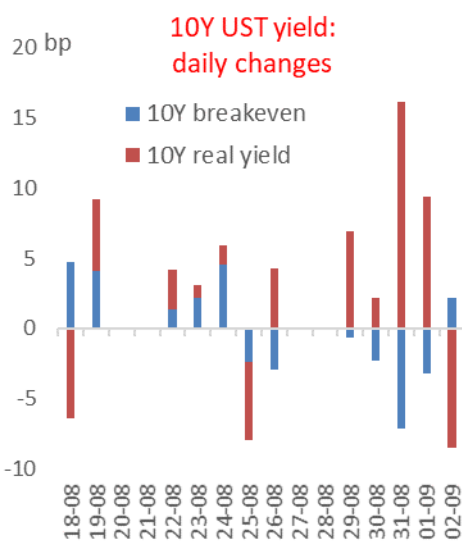
- The **UST** curve bullish steepened on Friday, as market pared back expectation for rate hikes after the payroll report. The change in payroll beat expectation, but wage growth did not accelerate while the jobless rate edged up amid a higher labour participation ratio. USD OIS now price in a 55% chance of a 75bp hike at the September FOMC, versus 70% priced prior. The 10Y nominal yield fell on the back of lower real yield, in line with our view that the rapid uptick in real yield would face some resistance. Yields may continue to trade in relatively wide ranges as rate hike expectations fluctuate, with the 2Y UST yield likely capped at 3.50% before the materialization of the September Fed rate hike with some easing in 2023 still in the price. This week brings US PMI, ISM, and jobless claims.

- **Gilts** underperformed on domestic politics and inflation fears. Any fiscal stimulus measures will risk fanning inflation further, and at the same time adds to supply. GBP OIS is pricing in a 68% chance of a 75bp rate hike at the September MPC, and 276bp of additional rate hikes (including the September one) in the rest of the cycle. While risk is that the BoE under-delivers on rate hikes, rate hike expectation is not the sole factor pushing up Gilt yields. Hence, despite the overly hawkish pricing, investors may still stay defensive.



Source: Bloomberg, OCBC

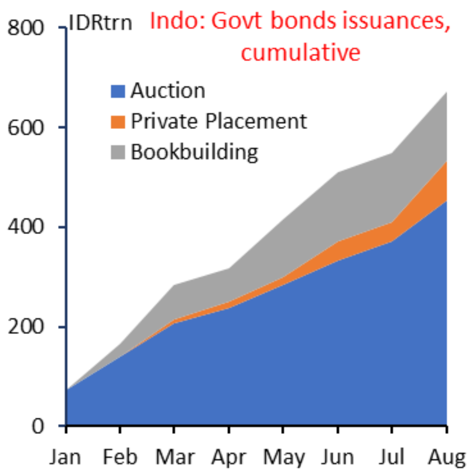
- **DXY. Entering Overbought Soon.** A combination of risk-off sentiments and stronger US data saw a late surge in DXY into NY close. Energy woes in EU worsened as Russia said it will indefinitely suspend natural gas flow to Europe. This adds to global growth concerns. On US data last Fri, the stronger than expected payrolls print leaves options open between a 50bps and 75bps hike at 21 Sep FOMC, though expectations seem to be a little tilted towards a third back-to-back 75bps hike. Nonetheless, it is still worth pointing out that despite NFP beating expectations, the pace of job growth in the US is slowing with Aug print of 315k job gains underwhelming 3month average of 378k while wage pressure has also softened slightly with MoM pace at 0.3%, down from 0.5% in previous month. We continue to keep a look out for any softening in US data that may hint at any turn-around in USD. ISM services data tomorrow and Aug CPI report due next Tue (13 Sep) may provide more clues. DXY was last at 109.91 levels. Bullish momentum on daily chart remains intact while RSI is near overbought conditions. Resistance at 110.15 levels. Support at 109.30, 108.70 levels. US markets are closed today for Labor Day holidays.

- **EURUSD. Weighed by Energy Woes.** EUR fell as worsening energy woes in Europe heightened risks of stagflation in EU. Russia said it will indefinitely suspend natural gas flow to Europe via the key Nord Stream pipeline after G7 agreed to an oil price cap for Russian crude. It was reported that one of the world's largest steelmaker, ArcelorMittal will reduce European production capacity, closing 2 of its plants in Germany amid rising electricity costs. Other energy-intensive industries like fertilizer, chemical production and glass making may potentially consider similar move to reduce production if energy costs continue to spiral. There have also been chatters of energy-rationing in EU ahead of Winter. Slower output could pose further drags of EU's economy. Over the weekend, German government has unveiled a EUR65bn package that includes public transport subsidy, cash payment, delay to the increase in carbon emission prices, etc to protect consumers, with a levy on windfall profits. EU energy ministers are scheduled to meet on 9 Sep when energy prices are to be debated and there may possibly be a potential structural reform of the electricity market. A favourable outcome may help to ease price pressures overall and to some extent, mitigate recession fears in Euro-area. But in the meantime, energy crisis could drag on EUR. This week also brings ECB meeting on Thu. Recent ECB speaks and hotter than expected CPI print have guided for hawkish re-pricing of ECB. Markets are 50-50 split between 50bps and 75bps hike. A hawkish ECB may provide some support for EUR. Pair was last at 0.9920 levels. Mild bearish momentum on daily chart remained while RSI shows signs of re-visiting oversold conditions again. Support at 0.9910, 0.9850 levels. Resistance at 1.0010 (23.6% fibo retracement of Aug high to low), 1.0080 levels (38.2% fibo).

- **GBPUSD. Many negatives maybe in the price for now.** Focus today is on who the next PM will be. Liz Truss who currently leads Sunak in polls is likely to be made PM. Results of the Conservative party leadership vote will be announced at 630pm SG time and appointment will take place on Tue, and then the PM will appoint a cabinet thereafter. The short GBP trade on the back of stagflation and political proxy play has been popular this year and could still remain intact broadly. But we opined that the recent sell-off may have been a little excessive. Caution may be warranted as many GBP-negatives may already be in the price and some of these political discounts may ease a little. GBP was last at 1.1480 levels. Bearish momentum on daily chart intact but RSI is in oversold conditions. Support at 1.1410. Resistance at 1.1620, 1.17 levels. This week, BoE Governor and BoE MPC will testify to parliament on Wed.

- **USDJPY. Bias to sell rallies.** USD/JPY traded a high 140.80 on Fri post-US payrolls before easing lower, tracking moves in 2Y UST yield. While widening of UST-JGB yield differentials have been a key factor driving USDJPY higher, we should not discount intervention risks. The last time USD/JPY was above 140 in the late 1990s, the Japanese intervened. There is a risk that any sharp near-term move towards the 142/143 could probably spark a much sharper verbal tone from Japanese authorities and put intervention back on the agenda. Pair was last at the 140.20 level. Bullish momentum on daily chart is intact while RSI is rising into overbought conditions. Bias remains to lean against strength. Resistance at 140.80. Support at 139.20, 138.30 levels.

- **IndoGBs** traded in narrow ranges on Friday, while there were opposing flows on USD/IDR as well. Over the weekend, some fuel price hikes were announced, with the price of Pertalite up by 30.7%, and the price of non-subsidized Pertamax up by 20%. While the hikes had been expected, they do add to inflation. Our economist sees inflation crossing above 7% YoY in the coming months, and a risk that core inflation will be above 4% by year-end. Inflation pressure and the subsequent policy rate hike prospects, together with BI's operation twist, are likely to keep the IndoGB curve flat. We continue to see the 10Y IndoGB yield within a 7.0-7.20% range near-term. The sukuk auction on Tuesday has an indicative target of IDR9trn. Thus far, MoF is well on track with its funding plan and there is likely to be upsizes only when yields are seen as favourable.



Source: DJPPR, OCBC

- Back-end **CNH points** rose during NY session upon the lower US yields. Given the retracement and likely consolidation in US yields in the coming days, and policy risk domestically (e.g. reserve on foreign currency deposits), investors may not want to chase back-end CNH points lower. In addition, potential outright flows may also prevent the points from falling much further near-term before the FX sentiment turns. Onshore CNY rates traded on the soft side amid lingering growth concerns as more small-scale lockdowns have been announced. Daily OMOs stayed neutral with light maturity. We have to wait till 15 September for the CNY600bn of MLF maturing, which presents an opportunity for the PBoC to withdraw some liquidity from the market.

Source: Bloomberg, OCBC

- **USD/SGD. Supported but nearing overbought**. USDSGD drifted higher, tracking broad USD strength and risk-off sentiment. S$NEER is trading 1.13% above the midpoint. Pair was last at 1.4035 levels. Bullish momentum remains intact while RSI is rising towards near overbought conditions. Bias to fade upticks. Immediate resistance at 1.4060 and 1.41 levels (Jul high). Support at 1.40, 1.3935 (23.6% fibo retracement of 2022 low to high). Today brings SG retail sales data.

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