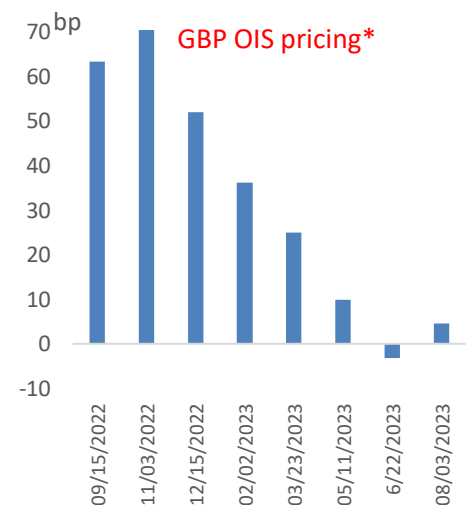


Rates and FX Themes/Strategy

- DXY. Bulls Running into Fatigue.** Recent decline in risk proxies paused overnight as further drop in oil prices (>15% fall in Brent since 30 Aug) eased concerns of inflation. UST yield slipped with 2y backing away from 3.5%. Last at 3.43%. DXY also turned lower, breaking below 110-handle. Fed's Beige book overnight reported that US economic expansion prospects were weak and price growth showed signs of decelerating. This is consistent with our earlier observation that price pressures (i.e. wage growth, core PCE, ISM prices, etc.) are slowing. We acknowledge that it may be too soon to declare victory on the fight against inflation but it is worth keeping a look-out on how slowing US data may influence Fed signalling in coming months (given that Fed is data-dependent) and that can translate into USD easing especially if EUR can find relative stability. DXY was last at 109.80 levels. Bullish momentum on daily chart is fading while RSI is falling from overbought conditions. Risks are to the downside. Support at 109.30, 108.30 levels (21 DMA). Resistance at 110.50, 111 levels. Fed Chair Powell, Evans, Kashkari are scheduled to speak later tonight before Waller and George tomorrow. Thereafter, Fed speaks will enter into blackout period starting Saturday ahead of FOMC (22 Sep).
- USTs rallied across the curve as oil prices fell.** Both the 10Y breakeven and 10Y real yield fell, contributing to the fall in the 10Y nominal yield. At the front-end, USD OIS pricing was little changed with 64% chance of a 75bp hike at the September FOMC seen, when Fed comments stayed hawkish. Brainard repeated that the Fed needs to hike rates to restrictive levels and keep them there for "some time". Earlier, Mester opined that rate needed to be raised to above 4% by early 2023. The 34bn of 52W bills cut off at 3.46%, 26bp higher than prior, while b/c ratio was lower at 2.75x and indirect award lower at 56.5%. Investors appear to have turned slightly defensive at the front-end. Level to watch for the 2Y UST stays at 3.50%. Jobless claims is due out tonight but the key will be CPI on 13 September.
- Front-end Gilts outperformed, with the 2Y yield plunging by 18bp.** Comments from individual BoE MPC members were in line with their respective usual stances – hawks stayed hawkish and doves stayed dovish, providing no additional piece of inflation. What moved the market was the BoE's assessment on the potential impact of the energy bill. BoE Chief economist Pill commented that the energy bill will "weigh on" inflation. GBP OIS pricing became less hawkish now pricing in additional rate hikes of 257bp for the rest of the cycle from as much as 280bp; and equally split between a 50bp and a 75bp hike at the September MPC meeting. Impact of the energy bill is two folded; while potentially mitigating inflation pressure, it also adds to supply risk. More details on the energy bill are expected to be unveiled as soon as tonight. Unverified amounts touted have been in the range of

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Source: Bloomberg, OCBC
*expected changes at the respective meetings

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GBP100-130bn over an 18-month period, which if came through is not an insignificant amount. The overall impact could be for a steeper Gilt curve. That said, another uncertainty emerged overnight, on BoE's QT plan.

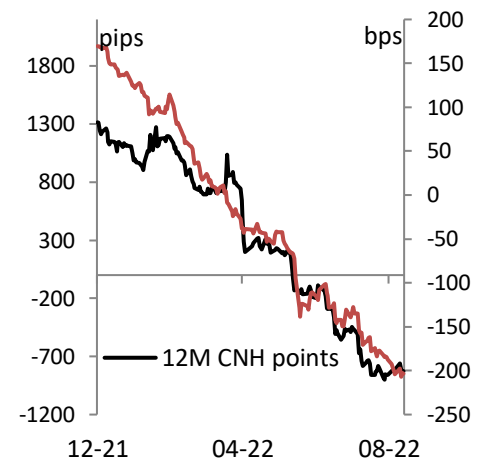
- BoE QT.** Bailey said the BoE might revise plans to start selling gilts next month if it judges that the market cannot digest the supply needed to fund the energy bill. To recap, balance sheet run-off has started, and for the next 12 months it will amount to around GBP40bn. In addition, the BoE has put forward a preliminary plan – supposed to be voted on at the upcoming MPC – to actively sell bonds amounting to another GBP40bn over the next 12 months. We watch for the final decision at the September MPC but would see the bar as high for the BoE to step back from its plan. For now, the strategy shall be to express the view for the market to adjust to the less hawkish side via front-end GBP OIS.
- EURUSD. ECB in Focus Today.** Our house view leans more towards 50bps hike though we note that markets are evenly split between 50bps and 75bps hike. ECB hawks want 75bps to be considered at the upcoming meeting and QT debate to commence by year-end. A more hawkish ECB should keep EUR supported. We also keep in view the extraordinary meeting of EU energy ministers (9 Sep) and European Commission President Ursula's state of the union address to EU parliament (14 Sep) on potential structural reform of the electricity market as Ursula had said that an "emergency intervention" is required to bring down rising energy prices. A favourable outcome may help to ease price pressures overall and mitigate recession fears in Euro-area, to some extent. EUR was last at 0.9985 levels. Mild bearish momentum on daily chart faded while RSI rose. Resistance at 1.0010 (23.6% fibo retracement of Aug high to low), 1.0080. Support at 0.9910, 0.9850 levels.
- GBP. Truss to Detail Energy Support Plan Today.** GBP saw a dip to 1.1406 levels overnight – its weakest level since 1985 before rebounding a big figure higher. Market awaits PM Truss's detailed energy support package today. She had indicated that she is against a windfall tax and preference is to use more UK oil, gas and nuclear. She also mentioned about opening up North Sea supply and to build more nuclear power. More of these plans will come later today. She is also expected to announce cap of about GBP2,500 on energy bills. It remains unclear at this point how long the support will last and where the funding come from. There were however calls for the creation of a government-backed superfund from which they could borrow from to subsidise bills while BoE Governor Bailey yesterday suggested to parliament that the BoE may take into consideration the government's energy package when deciding on the amount of GILTs to sell or start date of program. BoE Chief Economist Huw Pill said that natural gas has big impact on inflation and agrees that some energy price caps

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would reduce inflation. This pare back market expectations for faster pace of BoE tightening. GBP was last at 1.1520 levels. Bearish momentum on daily chart intact but shows tentative signs of fading while RSI shows early signs of turnaround from oversold conditions. Bounce not ruled out though GBP short as a stagflation proxy trade remains intact. Support at 1.1406. Resistance at 1.1620, 1.17 levels.

- Back-end **CNH points** rose overnight on the lower US yields and were consolidating this morning. Offshore implied CNH rates stay relatively high, at 2.48% for the 12M versus 2.05% onshore while the 1Y repo CNY IRS is at 1.91%. The lower onshore curve shall remain as a pulling factor for offshore DF, short-term fluctuations aside. Onshore CNY IRS were trading on the firm side this morning but price action was limited to 1-2bp. Widening in CNY-USD rates spreads (as in becoming less negative) is not in sight yet; instead, the bias shall be for further narrowing on a multi-month horizon. The next to watch is the CNY600bn of MLF maturing mid-month, where the PBoC is likely to take the chance to withdraw some liquidity from the market by partially rolling over the MLF. The weak yuan may add to the chance that the MLF rate will be kept unchanged, which is already the base case.
- **USD/SGD. Potential Double-Top Bearish Reversal.** USDSGD eased, tracking the move lower in UST yield, USD overnight. S\$NEER is trading 1.4% above the midpoint. Pair was last at 1.4060 levels. Bullish momentum remains intact while RSI eased from overbought conditions. Support at 1.40, 1.3935 (23.6% fibo retracement of 2022 low to high). Resistance at 1.41, 1.4140 levels. Intra-day look for 1.4000 – 1.4090 range.



Source: Bloomberg, OCBC

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