OCBC TREASURY RESEARCH

Daily Market Outlook

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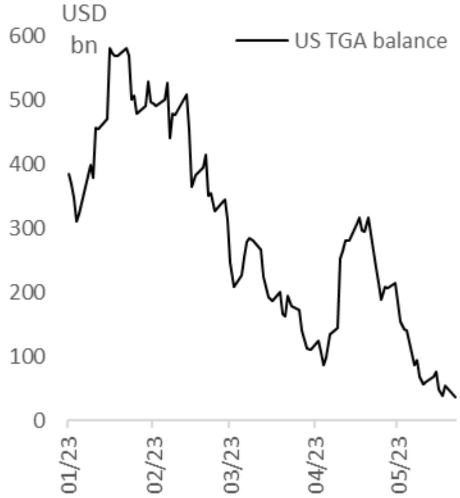
- **UST yields** edged further lower across the curve as market continued to adjust from previous hawkishness, but yields are stabilizing at Asia open. Fed funds futures pared back slightly rate hike expectation, but still looking for an 84% chance of a 25bp hike by the July FOMC meeting. Fed commentaries coming in over the past weeks have been well balanced, among opinions of upcoming decision being a close call, inclination to pause/skip, the need to do more, and decision being highly data dependent. Overnight, Harker (voting this year) commented that the FOMC "can take a bit of a skip for a meeting". Jefferson (voting) opined that "skipping hike" would allow time to assess data but emphasized a pause at a coming meeting doesn't mean rates at peak. We have been of the view that if the notion that "a pause is not necessarily an end" gains traction in driving market expectations, it would then be an easier decision for the FOMC to pause. Meanwhile, Collins (not voting) and Bowman (voting) focus on fighting inflation. We are biased to interpret hawkish remarks as intending to prevent the market from becoming overly dovish in case the FOMC decides to pause in terms of rate hike. We maintain our call for a pause at the June FOMC meeting and our call for no rate cut this year.

- **Potential bill and bond supply**. Progress on the debt ceiling deal has been constructive, and the yield premium on bills that mature in early June had earlier retraced much lower already. Market prepares for a pick-up in bill and bond supply. US Treasury is likely to look to replenish its cash position. Treasury's quarterly refunding plan has an estimate of its cash balance at USD550bn by end-Q2 and USD600bn by end-Q3 – but we suspect the rebuilding of cash may be paced out through Q3. To fund fiscal spending, we reckon US Treasury may need to catch up with net issuances amounting to around USD350-380bn this quarter. These issuances shall not be seen as entirely "extra"; they represent delayed supply – there have been hundreds of billions of net supply each quarter. There will be implications on liquidity as supply are concentrated over a shorter period of time, which may affect T-bills more than USTs. That said, with bill yields at above 5% now, there is a fair chance that some funds will be mobilized from the Fed's reverse repos, assuming the FOMC does not hike rates this month. On balance, these bills are likely to be readily absorbed and we are not expecting substantial impact on yield levels. On bond side, USTs shall be mostly driven by macro themes – Fed funds rate hike/cut prospect against the backdrop of inflation and labour market development. Our expected Fed funds rate trajectory is consistent with a 2Y UST yield at around 4.3%-4.4%.



Source: Bloomberg, OCBC Research

- **DXY. *Consolidate*.** House just voted 314-117 to approve the debt ceiling agreement struck by Biden-McCarthy, as widely expected. The deal now heads to the Senate just before the 5 June x-date. Senate Majority Leader Chuck Schumer said the Senate will do everything to move the bill quickly. To take stock, the deal, when passed will suspend the debt ceiling till 1 January 2025 in exchange for spending cuts. Market reaction on House passing the vote was largely muted. Instead, FX markets reacted positively to China Caixin manufacturing PMI, which swung into expansionary territory (50.9 vs. 49.5 expected). This was a welcome relief for markets. USDCNH spot fell nearly 200pips (as of writing). Elsewhere on Fed speaks, we noted more chatters on Fed pause or skip (new choice of word) at upcoming FoMC. Jefferson signalled that the Fed is inclined to keep rates steady in June while Harker said the Fed should skip a rate hike in June. Market pricing for a hike by July has eased slightly (84% probability vs. 95% probability at start of the week). Our house view still looks for Fed pause. Focus next shifts to ADP employment, ISM manufacturing (Thu) and payrolls (Fri) data. Some softness on labour data can weigh on USD. One risk to watch is the extent of CNH swings. Any sustained price action above 7.12 levels could risk de-anchoring sentiments and pose downward pressure to those FX highly sensitive to RMB, including MYR, THB and to some extent even EUR. DXY was last at 104.21 levels. Bullish momentum on daily chart shows signs of easing while RSI shows signs of turning from overbought conditions. Support at 104 (61.8% fibo), 103.40 (50% fibo) and 102.75/90 (38.2% fibo, 21, 100 DMAs). Resistance at 104.70 (76.4% fibo retracement of 2023 high to low), 105.15 and 105.65/80 levels (2023 high, 200 DMA).

- **EURUSD**. ***CPI in Focus.*** EUR attempted to trade lower overnight, briefly testing below 1.0640 before a sharp turn around. Pair firmed modestly on release of better-than-expected China Caixin mfg PMI. Pair was last at 1.0690 levels. Bearish momentum on daily chart intact but shows signs of fading while RSI is near oversold conditions. Support at 1.0640/50 (76.4% fibo retracement of 2023 low to high). But if this decisively broken, the next support levels are at 1.06, 1.0540 levels. Resistance at 1.0740 (61.8% fibo), 1.08 (50% fibo), 1.0820 and 1.0870 (38.2% fibo). Today's CPI estimates for May should offer some insights into how persistent CPI maybe and if there is further room for ECB to tighten. Consensus is looking for headline at 6.3% YoY vs. 7% in April and for core CPI to remain sticky around 5.5%. Softer print could drag EUR lower.

- **GBPUSD. *Bearish Momentum Fades.*** GBP continued to build on momentum to trade higher. Pair was last at 1.2440 levels. Bearish momentum on daily chart shows signs of fading but rise in RSI slowed. Sideways trade likely. Resistance here at 1.2440 (50 DMA), 1.2470

(23.6% fibo, 21 DMA). Support at 1.2345 (38.2% fibo), 1.2290 (100DMA) and 1.2240 (50% fibo retracement of Mar low to May high).

- **USDJPY. *Still Looking for Downside Play.*** USDJPY fell further in line with our call for downside play. Move lower came amid pullback in UST yields and cautious of leaning against the wind activities. Recall that MOF-FSA-BOJ met on Monday and top currency official said that the government will continue to closely monitor market moves and will take appropriate responses if necessary. We do not expect officials to lean against the wind so soon but to rely on verbal intervention to slow JPY's depreciation pace if need arises. In any sense, intervention typically buys time or delay/slow pace of depreciation. A turn in trend would require UST yields to ease off or a BoJ to shift policy. Pair was last at 139.45 levels. Bullish momentum on daily chart is fading while RSI turned lower from overbought conditions. Rising wedge pattern breached to the downside –bearish reversal played out. Support at 138.80, 138.20 levels. Resistance at 139.60, 140.20 and 142.50 (61.8% fibo retracement of 2022 high to 2023 low).

- **USDSGD. *Toppish?*** USDSGD eased slightly from recent highs, tracking USD, UST yields lower while RMB softness found relief on better-than-expected Caixin manufacturing PMI. Pair was last at 1.3520 levels. Daily momentum remains bullish bias while RSI eased near overbought conditions. Support at 1.3450 (23.6% fibo), 1.3370 (38.2% fibo retracement of 2023 low to high) and 1.3340 (50, 100 DMAs). Resistance at 1.3550, 1.3576 (2023 high). S$NEER was last at +1.33% above model-implied mid.

- **CNY *rates*.** CNY rates continued to trade on the soft side and liquidity has stayed flush. The 7-day repo and t/n point fell while the PBoC net withdrew a negligible CNY5bn of liquidity via OMOs this morning. The rates market did not react to the mildly firmer Caixin manufacturing PMI, with expectation still for a supportive monetary policy. We are neutral CNY rates near-term. Back-end CNY and CNH stay as a function of CNY-USD rate differentials and rose over the past day on lower USD rates. A turnaround in CNY-USD rates differentials is not on the horizon, and likewise we cannot be optimistic about bond inflows into China.

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