OCBC TREASURY RESEARCH

Daily Market Outlook

13 January 2023

Disinflation Hopes

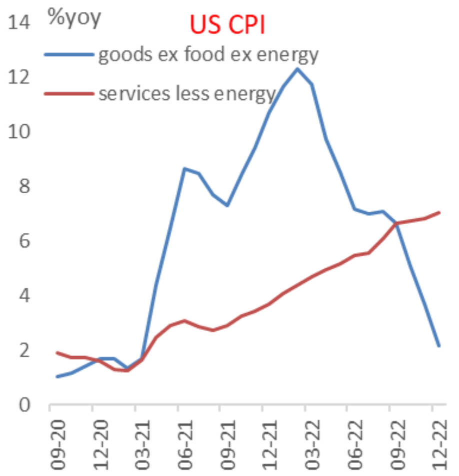
Frances Cheung, CFA
Rates Strategist
+65 6530 5949
FrancesCheung@ocbc.com

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

Treasury Research
Tel: 6530-8384

- **UST** yields slid upon the CPI release followed by dovish remarks from Harker. Harker, who has appeared on the hawkish side within the committee, opined that "hikes of 25bps will be appropriate going forward". Fed rate hike pricing eased mildly to less than a 10% chance of a 50bps hike at the February FOMC meeting; our base-case has been a 25bps hike. Again, the movement in bonds was more than that can be explained by changing rate hike expectations alone. Positioning has been another key factor, as suggested by the still heavy net short futures positions across the 2Y to the 30Y sectors which may lead to further short-covering flows. Treasury futures softened mildly in Asia hours.

- **US CPI**. Headline inflation eased to 6.5% YoY in December from 7.1%, while core inflation eased to 5.7% YoY from 6.0%. The softening in inflation was primarily due to slower goods price inflation as energy prices fell month-on-month. Services price inflation picked up to 7.52% YoY in December after a brief stabilization in November, while core services price inflation has continued to accelerate, to 7.05% YoY in December. The deceleration in goods inflation is consistent with the easing in supply chain disruption, while the lingering inflation pressure in the services sector may reflect more of demand-side factors when the labour market stays tight. The divergence in the trend for goods versus services inflation shall underline the notion for the Fed to switch to smaller rate hikes yet to hold rate at a high level for some time.



Source: CEIC, OCBC Research

- **DXY. Sell Rallies**. USD took another leg down south on US CPI and Fed's Harker's comments. On CPI, data was largely within expectations with no major surprises but the confirmation of a deceleration in price pressures is building up hopes that CPI could fall further in coming months. An entrenched disinflation trend can reinforce expectations that the Fed could again scale back on its pace of hike beyond the February FoMC or even position for an earlier pause or dovish pivot. Softer CPI puts Bostic's comments in focus. In particular, he said the case for reducing the size of Fed hike to 25bps would be boosted if CPI shows prices cooling while Harker, Susan Collins yesterday said they supported smaller 25bps hike going forward. As of now, markets are already pricing in 25bps hike at the next FoMC. DXY fell; last at 102.25 levels. Daily momentum shows tentative signs of turning bearish while RSI fell to near oversold conditions. Risks remain skewed to the downside. Key support here at 102.15 (50% fibo retracement of 2021 low to 2022 high), 101.50. Resistance at 103.90 (21 DMA), 105.1 (38.2% fibo) and 106.40 levels (200DMA). Today brings the University of Michigan consumer sentiment data. Consensus is looking for a 3rd straight improvement (expectations at 60.5 vs. 59.7 in December). Consumption has held up relatively well as the strong labor market

Source: Bloomberg, OCBC Research

continues to boost sentiment and incomes. Both 1- and 5-year inflation expectations are also seen steady at 4.4% and 2.9%, respectively.

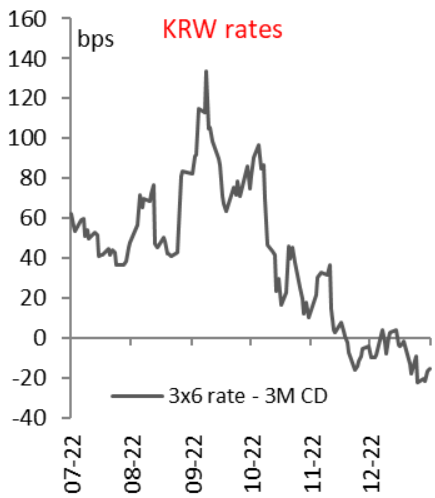
- **EURUSD. Supported; Buy Dips Favoured.** EUR extended its move higher amid softer USD on US CPI while hawkish ECB speaks so far this week seemed to suggest no let-up in tightening to arrest inflationary expectations. EUR was last at 1.0850 levels. Daily momentum is showing tentative signs of turning mild bullish while RSI is rising. Risks skewed to upside but we won't rule out any near term profit-taking any short term objectives have been met. Next resistance at 1.0870, 1.0940 and 1.1040 (76.4% fibo) levels. Previous resistance at 1.0750 levels (61.8% fibo retracement of 2022 high to low, trend upper bound) now turned support before 1.0660 (21 DMA), 1.0520 (50% fibo, 50DMA). We are biased to buy dips. On ECB speaks, Rehn said increases in interest rates must still rise significantly to reach levels restrictive to ensure a return to 2% medium term target while De Cos said the ECB will deliver big increases in borrowing cost at next meetings. Earlier this week, Centeno said that increases in borrowing costs must persist until inflation is on a sustainable path to 2% target. He said there is no alternative that to carry out the process of normalisation and increasing interest rates that started at end-2021. Schnabel said that rates will still have to rise significantly at a steady pace to reach levels that are sufficiently restrictive to ensure a timely return of inflation to ECB's 2% medium-term target.

- **GBPUSD. Supported.** GBP rose amid a weaker USD on the back of decelerating US CPI as well as hawkish BoE. Catherine Mann said that underlying inflation is pretty robust, in contrast to earlier comments from BoE chief economist who said that inflationary pressures in UK may be easing as labor market weakens and the economy heads into recession. Nonetheless with a softer USD in the background, markets took it as a signal that Catherine is still pushing for big interest rate increases. Recall she was the single voter for 75bps hike at the MPC last month. GBP was last at 1.2215 levels. Daily momentum shows signs of turning bullish while RSI rose. Golden cross formed, with 50DMA cutting 200DMA to the upside. Risk modestly skewed to the upside. Resistance at 1.2220 levels. Support at 1.2090 (21 DMA), 1.2050 (50% fibo retracement of 2022 high to low). Earlier this week, BoE Chief Economist Huw Pill said that inflationary pressures in UK may be easing as labor market weakens and the economy heads into recession. He added that "should economic slack emerge, and unemployment rise as latest MPC projected, that will weigh against domestic inflationary pressure and ease the threat of inflation persistence.

- **USDJPY. 21DMA Caps Advance.** USDJPY fell further overnight on USD's decline post CPI release and Harker's comments while the earlier Yomiuri report (based on unconfirmed sources) on potential BoJ move kept demand for JPY intact. On US CPI, even though data was largely within expectations, the confirmation of a deceleration in price pressures is building up hopes that CPI could fall further in coming months. An entrenched disinflation trend can reinforce expectations that the Fed could again scale back on its pace of hike beyond the February FoMC or even position for an earlier pause or dovish pivot. Moving to JPY side of the equation, the BoJ did another round of unscheduled bond buying this morning in attempt to cap the rise in JGB yields. 10Y JGB yield is already testing above the upper bound of the YCC cap of +0.5%; last seen at 0.509. The Yomiuri report earlier indicated that BoJ will review the side effects of its recent policy changes at its next BoJ MPC (18 January) and that BoJ will consider adjusting its bond purchases and make further policy tweaks if it believes they are necessary. Rising likelihood of another BoJ move drove demand for JPY. Pair was last at 129.10 levels. Mild bullish momentum on daily chart faded while decline in RSI moderated. Bias remains to sell rallies. Support at 127.30, 126.40 levels. Resistance at 132.50 (21 DMA), 134.80 levels. On the weekly chart, bearish momentum remains intact. Price action exhibits a head and shoulders pattern – bearish reversal. A break below 130 support could see losses accelerate towards 127.30 (50% fibo).

- **USDSGD. Consolidate.** USDSGD continued to trade with a heavy bias. US CPI report and Harker's remarks were the catalysts for a softer USD overnight. But the move lower in USDSGD appears to have run into fatigue given the sharp and near-one way move since October last year. Pair was last at 1.3220 levels. Daily momentum is bearish while RSI fell. Bias still for downside play but move lower from here could be a grind. Support at 1.3210, 1.3160 levels. Resistance at 1.3290, 1.3320. S$NEER is 1.16% above model-implied mid.

- **KRW IRS** fell as the Bank of Korea hiked its policy repo rate by 25bps as expected. Despite the somewhat mixed comments from the BoK thus far, we see this as the final hike in this cycle. The MPC statement dropped the phrase "The Board sees continued rate hikes as warranted for some time" and replaced it by the opinion that the Board deems it "warranted to maintain the restrictive policy stance". Maintaining the restrictive policy stance shall be understood as keeping the policy rate at the current level, in our view, although Governor Rhee in the press conference commented that the statement did not mean rate would be kept frozen. On bond side, there is room for KTBs to outperform USTs, benefiting from potential index inclusion which may lead to passive flows of up to USD50-63bn over a 12 to 18-month period; the amount is significant compared to other balance of payment items. Index-induced passive flows are not imminent – inclusion is yet to be confirmed and there will be a time lag in implementation, but the optimism surrounding the potential,



Source: Bloomberg, OCBC Research

together with a peaking of the policy rate, is painting a constructive backdrop for KTBs.

- **CNY rates**. The PBoC injected CNY55bn of liquidity via 7-day reverse repos and CNY77bn via 14-day reverse repos this morning, continuing to prepare the market for the Chinese New Year. As the CNY700bn of MLF maturity comes ahead of the Chinese New Year, a full coverage of the liquidity as a minimum is probably needed – but it is a matter of the use of instruments; if part of the liquidity is compensated for by short-term reverse repos, it would be a disappointment to the market. Front-end implied CNH rates have played catch-up with onshore to reflect the tight liquidity situation. Back-end CNH points went higher on the lower US yields; our medium-term strategy stays as buy-on-dips on back-end points.

- **SGD rates**. SGD OIS fell by 5-7bps at open but have since stabilized, with mixed relative performances vis-à-vis USD rates at different tenors. Front-end SGD-USD OIS spreads have turned less negative over recent sessions, moving to ranges which are nearer our expectations. Next focus is the announcement on 18 January of the size of the first auction of the year – the reopening of the 10Y SGS, where demand is likely to be decent after previous absence of supply.

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

Chin Meng Tee
Credit Research Analyst
mengteechin@ocbc.com