OCBC TREASURY RESEARCH

Daily Market Outlook

25 January 2023

US bill supply and Fed reverse repo

- **UST** yields initially rose upon the rebounds in US PMIs but have since retraced lower and the gains in bonds were sustained upon the rallies in Bunds and Gilts and the strong 2Y coupon (US) auction. The 2Y bond cut off at 4.139%, 1.3bp below WI level despite cheapening into the auction; bid/cover ratio edged higher to 2.94x and indirect accepted higher to 65%. Fed funds futures pricing was little with roughly 25bp hikes in Q1, which has been our base case. Treasury futures were trading firmer in Asia morning amid the mixed risk sentiment.

- **Bill supply and reverse repo**. At the short-end, usage at the Fed's o/n reverse repo facility fell by USD87bn to USD2.048trn on Tuesday, amid net bills issuance (settlement) of USD101bn on the day; another USD9bn is to be settled on Thursday. Changes in the usage at the reverse repo facility has acted as a buffer to the liquidity drainage from increased bill supply, with recent cut-offs at bill auctions ranging from 4.48% to 4.685% across the 4W to 6M tenors versus 4.3% paid on the funds parted at the reverse repo facility. After the big fluctuations around the turn of the year, usage on Tuesday was down USD140bn compared to that on 3 January. Meanwhile, net bill issuances were at around USD186bn. Whether the drop in the usage at the reverse repo reflected a short-term reaction to settlement need, or it will be sustained and run further remains to be seen. If money market rates are not appealing enough to attract more funds away from the facility when liquidity becomes overly tight (amid ongoing QT), a wider spread between the o/n RRP rate and the rate paid on bank reserves cannot be ruled out. That said, thus far the FOMC's stance appears to be that market forces will do the job, and liquidity is not undesirably tight. At the December FOMC minutes, the Committee opined that "greater competition among banks for funding could contribute to drawdowns" in the (reverse repo) facility over time.

- **Gilts** outperformed. Data/news flows coming through have been mixed. UK manufacturing PMI improved to a better-than-expected 46.7 points – new orders rose while employment fell, but services PMI went deeper into contraction – input prices rose while employment fell. Separately, the BoE has reportedly agreed on a 3.5% pay increase, and a one-off 1% salary top-up for this year. Our base case is a 50bp at the February MPC meeting, to be followed by a 25bp hike in March bring the Bank Rate to 4.25%; by then the BoE is probably done. GBP OIS pricing of a terminal rate at 4.50% looks roughly fair. Our view for Gilts to underperform GBP OIS has panned out well; as Gilt supply stays on the high side, we hold onto this view for now. That said, this underperformance may not be as rapid as that was observed over the past couple of months as the spreads have adjusted while BoE completed its sales of temporary holdings of bonds.

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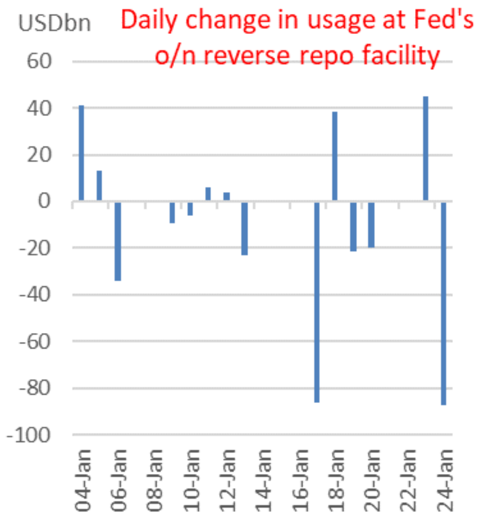
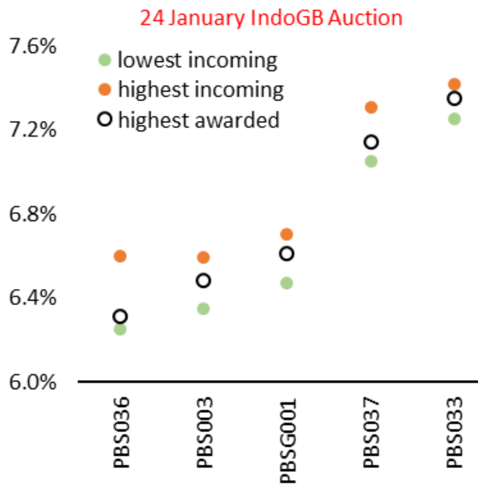


Source: Bloomberg, OCBC Research

- **SGD rates and SGD**. SGD OIS were trading soft this morning with limited price action, as USD rates did a round trip overnight. Given the fairly negative SGD-USD rates spreads, room for further SGD rates outperformance is limited. The impact of any further MAS policy tightening may also be negligible as spot will probably reflect most of the reaction. 4W and 12W MAS bills are auctioned today; the 1M and 3M market implied SGD rates were at around 3.88/3.90% and 3.95/4.10% at the time of writing. SGD NEER was trading at 1.07% above mid-point this morning, having been on a downtrend over the past days, as the SGD underperformed the EUR and MYR. The recent SGD performance was in line with our medium-term view for the SGD to underperform against selected currencies upon a moderate-to-soft USD profile and a better risk sentiment. Against the dollar we retain a mildly bullish outlook on the SGD; if 1.3160 is broken again more decisively then next supports for USD/SGD are at 1.3090/10.

Source: Bloomberg, OCBC Research

- **IndoGBs**. Tuesday's sukuk auction attracted incoming bid of IDR28.546trn; IDR14.15trn of bonds were awarded a tad above indicative target of IDR14trn, in line with our view for near or at target issuance. Most of the bids went to the short-end – bills and PBS36 (2025 bond) – with cut-offs at or near the lowest incoming bid yields. Demand was mildly weaker at PBS33 (2047 bond) with cut-off near the highest incoming bid yield. Overall, the auction shall be considered as solid.



Source: DJPPR, OCBC Research

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