OCBC TREASURY RESEARCH

Daily Market Outlook

5 January 2023

China Optimism

- Most of the gains in **USTs** happened during Asia and London hours, alongside the rallies in Gilts and Bunds. UST yields fluctuated within narrow ranges during NY session amid the releases of US ISM manufacturing and FOMC minutes. The fall in the 10Y UST yield was driven by lower breakeven. ISM price paid unexpectedly dropped to 39.4 points, pointing to disinflationary momentum. French CPI also unexpected eased to 6.7%YoY in December from 7.1% prior. Meanwhile, Kashkari's comment does not deviate from what has been suggested by those higher dots on the Fed's dot-plot which may explain the subdued market reaction to his comments. The dot-plot is skewed upward, with seven dots above median.

- The **FOMC minutes** sounded hawkish, but not more hawkish than what had already been heard by the market, including the Committee's commitment to returning inflation to the 2% target and its caution against prematurely loosening monetary policy. The minutes noted the broad financial conditions are less restrictive than expected on higher equity values and the softer dollar – presumably pointing to more tightening to be done; but this opinion was somewhat counteracted by the assertion that monetary policy approached a stance that was sufficiently restrictive. Market stick with its own expectation for the Fed funds rate path, pricing a terminal rate at around 5.15% to be followed by some 40bp of rate cuts by year-end. Since the market is happy to price in some rate cuts, we expect the 2Y UST yield to peak somewhere below our expected peak effective Fed funds rate; still, further Fed rate hikes mean upward bias to the 2Y yield; we maintain forecast at 4.60%.

- Another point to note from the minutes which relates to our discussion of the liability side of the Fed's balance sheet is the Committee's view on the usage of the o/n reverse repo facility. The Committee said "greater competition among banks for funding could contribute to drawdowns" in the facility over time. This would be an important adjustment on the liability side, in the face of the shrinkage in the Fed balance sheet, to buffer the impact of QT on bank reserves. Higher repo rates and return on money market funds can also contribute to a reduction in the usage of the reverse repo facility, at a time when the expected change in the TGA is likely to impose a tightening impact – reduction in the TGA will likely turn slower with potential for a re-build later, assuming the debt ceiling issue will be resolved as it had been.

- **DXY. Near Term Rebound Risks but Bias to Fade**. USD eased after starting the year on a firmer note. FoMC minutes and hawkish remarks from Fed's Kashkari overnight did not seem to provide any lift for the USD while equities rebounded. We opined that the minutes was

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Source: Bloomberg, OCBC

largely within expectations. Dots plot in Dec had already indicated the Fed officials are now looking for another 75bps hike for whole of 2023 with no cut expected. Markets diverge from Fed's guidance – looking for a peak of 5% by May-2023 and pencilling a cut as early as Nov-2023. DXY last at 104 levels. Mild bullish momentum on daily chart intact while rise in RSI moderated. Falling wedge pattern appears to be playing out. This is typically associated with a bullish reversal in the near term. Resistance at 105.1, 106.2 (200 DMA). Support at 103.45 (interim double bottom – lows in Dec and Jan), 102.15. Seasonally speaking, January is typically a strong month for DXY. Based on monthly calendar returns since 2000, DXY rose on 14 Januarys out of 22 and on average, gained +0.58%, the highest amongst the 12 calendar months. But seasonality trends aside, it is important to pay attention to other price measures. ISM prices paid already showed a sharp decline to 39.4 from 43. Sharper deceleration in price pressures could feed into slower pace of Fed hike and possibly weigh on the USD. Bearing near term noises, we retain the overarching view that the upside for USD may be limited as pace of Fed tightening slows and goes into late cycle. Broad trend of USD for 2023 remains skewed to the downside. On risk sentiments, we are slightly more optimistic as a case of slower pace of tightening seen across most central banks and China reopening, support measures should help to partially mitigate against global growth concerns. A less severe global growth slowdown can also be supportive of cyclical FX, including AxJs while counter-cyclical USD stays on the back foot.

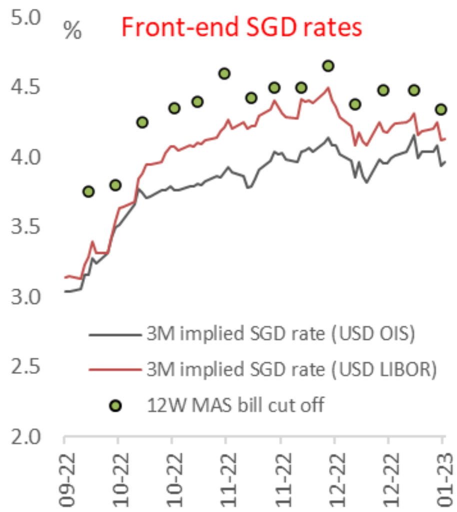
- **AxJs. Broadly Supported.** Developments out of China remain supportive of sentiments and Asian FX, including CNH, THB and KRW. Yesterday there were a number of positive news flow, support measures out of China: 1/ Chinese authorities are planning more support measures to ease liquidity stress and help shore up the balance sheets of some "systemically important" Chinese developers. Support measures could come in the form of equity financing, loans to allow creation of REITs and spurring acquisitions. There were also dribs and drabs of China relaxing property buying curbs. For instance, this week, Chongqing is the latest city to allow families to own more than 1 property if one of them is rented out on a long-term lease. Another city, Dong guan had on Monday lifted a ban on individuals buying new homes in the last five areas of the city that were still subjected to restrictions. The relaxation may appear to have little impact at the moment but taken as a whole, China seems to be shifting gears to a more relaxed regulatory environment as compared to last few years where there was tougher regulatory oversight on big tech, gaming, education, property sectors, etc. The shift can rebuild foreign investors' confidence and could lead to further inflows into RMB-linked assets, including equities. 2/ Another positive news for the private sector was the approval for Alibaba's Ant Group to raise $1.5b for capital expansion. Ant is still waiting approval of licenses to operate as a financial holding company and as a personal credit ratings firm.

Granting of these licenses would be another positive for sentiments, RMB-linked assets, RMB. 3/ China discussing plans to resume partial coal imports from Australia – a positive for commodities and AUD.

- **AUDUSD. Need to Clear 200DMA.** It was reported that China was discussing plans to resume partial coal imports from Australia. And recall that Australia Foreign Minister Penny Wong had recently made a visit to China and the potential easing of import ban may imply the beginning of more to come as relations could be on the mend. Tourism, education and property sectors in Australia could benefit if relations between China and Australia start to warm up. This is positive for AUD. Not forgetting China reopening story and Fed policy calibration thematic can also further add to long AUD bias. Pair now at 0.6840. Bullish momentum on daily chart intact. Immediate resistance at 0.6850 (200 DMA), 0.6920. Break above these resistance could point to further upside towards 0.70, 0.7140. Support at 0.6780, 0.6750 levels. Our tactical long AUDNZD trade (initiated on 20/Dec) on bullish divergence, targeting a move towards 1.0650 (first objective), 1.0725 and 1.0865 have met all objectives. High traded overnight was 1.0879. The idea is now closed.

- **EURUSD. Bullish Trend Channel Should Hold.** EUR partially retraced losses amid broad USD softness. Continued decline in European gas prices to pre-invasion levels due to mild weather conditions suggests that inflationary pressures may not be as bad as feared and this could help business to cope better. Pair was last at 1.0620 levels. Daily momentum is showing a mild bearish bias but decline in RSI moderated. Range-bound trade likely. Support at 1.0520 (50% fibo, lower bound of bullish trend channel) and 1.0380 (50 DMA). Resistance at 1.07 and 1.0750 levels (61.8% fibo retracement of 2022 high to low). While recession fears in Euro-area, energy woes and geopolitical concerns remain, we believe the bulk of the risks have been baked into the price (i.e., mild recession priced). Hawkish ECB rhetoric mitigates against further worsening in EU-UST yield differentials and that should continue to provide some support for EUR. But on the other hand, an overly hawkish ECB risks spooking equity markets, of which EUR has a strong correction to (coefficient of 0.81). Key risks to watch that may drag on EUR include (1) how severe EU recession turns out to be; (2) whether there will be further escalation in Russian-Ukraine tensions – poses risks to energy and inflation or would there be a ceasefire scenario; (3) if USD strength returns with a vengeance (i.e., global risk-off or Fed resumes aggressive tightening).

- **USDSGD. Heavy Bias.** USDSGD continued to trade with a heavy bias near recent lows but lack catalyst to push lower. Pair was last at 1.3420 levels. Daily momentum is mild bullish though RSI fell. Sideways trade likely near recent lows. Support at 1.3380/60 levels. Resistance at 1.3480 (76.4% fibo), 1.3670 (61.8% fibo retracement of 2021 low to 2022 high). S$NEER is 1.3% above model-implied mid.



Source: MAS, Bloomberg, OCBC

SGD rates. The cut-off for the 4W MAS bill came in at 4.20%. Although it was lower than the 4.25% at the last auction, it did not fall as much as implied SGD rate did during the same period. Meanwhile, the 12W cut-off at 4.34% was nearer to implied SGD rate (from USD LIBOR) than before. Overall, the results do not reflect additional information on the SGD liquidity situation which has already turned mildly flusher. The widespread for the 6M FRN, on the other hand, is subject to interpretation. Compared to 6M SGD OIS, a spread of 99bp meant a yield of 4.73% which was appealing. The recent low fixings on the overnight rate SORA might have complicated the calculation on investors' minds as the FRN references SORA itself though in a compounded manner. If past pattern holds, the cut-off at today's 6M T-bill auction is likely to come in somewhere below 4.30% - expected range at 4.10-4.20%, amid the supportive SGD liquidity.

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