

Dovish ECB Re-pricing Overdone?

- USD rates.** UST yields fell as data continued to print soft. The 2Y yield however rebounded from session low to end the day little changed; Fed funds future pricing was little changed as well (less dovish at the margin). November ADP employment change came in slower-than-expected at 103k while the previous number was revised downward; final reading of Q3 unit labor costs was -1.2%qoq versus preliminary reading of -0.8%. The fall in the 10Y yield since the high at end-October was driven by both lower real yield (around two-third) and lower breakeven (one-third); meanwhile, the 10Y term premium as estimated by the NY fed's ACM model fell by 34bps. It was a combination of softer data and oil prices leading to lower inflation and growth expectation, and probably a higher certainty seen regarding the expected falls in short rates, that have driven the UST rally where the longer end outperformed. Additional substantial falls in yields may not happen in the near term; we look for consolidation, with some upticks in yields especially at the longer end, over the coming weeks.

- DXY. Upticks.** USD extended its uptick overnight even as divergence between USD and 10y UST yields widened. Softer ADP employment and unit labour costs did little to derail the USD bounce that we've been cautioning for this week. The uptick in the USD may partially be attributed to position adjustment ahead of FoMC next week and partially due to softer EUR as market aggressively re-priced expectations for dovish ECB (150bps cut priced for 2024). Elsewhere, Fed fund futures are pricing in for the Fed to cut 124bps for 2024 and a 25bp cut in Mar is now >60% priced in. FoMC next week will carry dot plot and that will provide the first point of validation. This week's focus is on payrolls report, Uni of Michigan sentiment, inflation expectations (Fri). Upside surprise to US data will further fuel the short squeeze momentum but a downside surprise should see USD's rebound stall. DXY was last at 104.13 levels. Daily momentum is mild bullish while RSI rose. Mild upside pressure likely intra-day. Resistance at 104.50 (100 DMA). Support at 104.05 (21DMA), 103.50 (50% fibo retracement of Jul low to Oct high) and 102.50 (61.8% fibo). We look for better levels to sell rallies.

- EURUSD. Dovish Re-pricing Overdone?** EUR continued to trade with a heavy bias as markets aggressively re-price for a dovish ECB, expecting rate cuts of 150bps for 2024 and the first cut to come in at March is >50% priced. ECB rhetoric has turned less hawkish following the rapid fall in CPI. Amongst ECB officials, Schnabel, who is considered one of the more hawkish voice on ECB Governing Council appeared to have switched sides. She said that "ECB can take further rate hikes off the table given a remarkable fall in inflation and policymakers should not guide for rates to remain steady through mid-2024". Then again, we question if markets had gotten too far in pricing such dovish

Frances Cheung, CFA

Rates Strategist

+65 6530 5949

FrancesCheung@ocbc.com

Christopher Wong

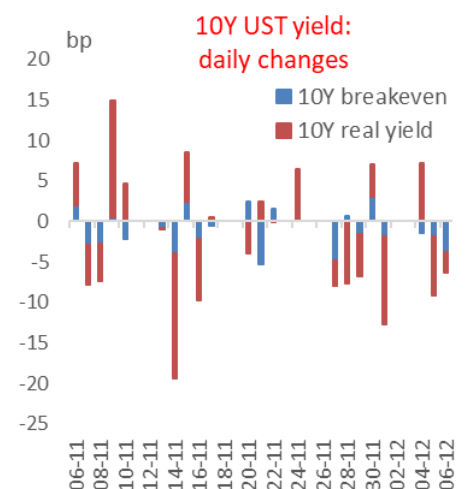
FX Strategist

+65 6530 4367

christopherwong@ocbc.com

Global Markets Research

Tel: 6530-8384



Source: Bloomberg, OCBC Research

Daily Market Outlook

7 December 2023

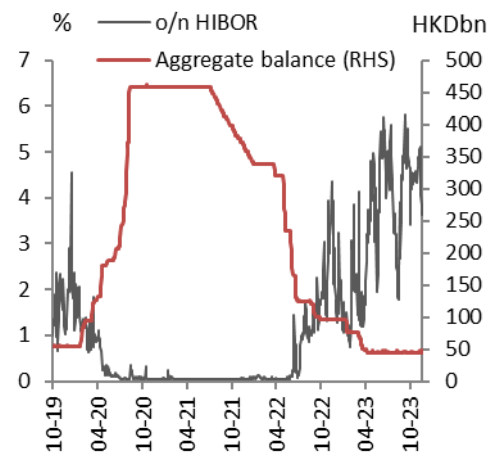
expectations. Villeroy said that ECB may consider rate cut in 2024 but not now while Kazimir has indicated that 1q rate cut is 'science fiction'. Kazaks also said there is currently no need to cut rates in 1H24. We caution that any pare-back in dovish expectations could lend support to EUR. EUR was last at 1.0767 levels. Daily momentum is bearish while RSI fell towards near oversold conditions. Near term risks skewed to the downside but watch out for potential reversal. Falling wedge pattern appears to be forming – this is typically associated with bullish reversal. Support here at 1.0770 (38.2% fibo), 1.07 (50 DMA). Resistance at 1.0820 (200 DMA), 1.0860 (50% fibo retracement of Jul high to Oct low) and 1.0960 (61.8% fibo).

- **AUDUSD. Inverted Hammer.** AUD gains reversed into the close overnight, but bears found little incentive to trade lower. Price action shows an inverted hammer, which can potentially point to a bullish reversal in the near term. We watch price action. Pair was last at 0.6550 levels. Daily momentum turned bearish while decline in RSI moderated. Consolidation likely intra-day. Support at 0.6530/40 levels (21 DMA). Resistance at 0.6592 (23.6% fibo retracement of Nov low to Dec high), 0.6620 and 0.6690 (Dec high).
- **USDJPY. Sell Rallies.** USDJPY traded a touch softer as rising market chatters that the BoJ is paving ground for an exit. These chatters came on the back of remarks made by BoJ Deputy Governor Himino. He outlined various potential impacts that would follow an exit and he pointed out that households would probably benefit from improved net income if rates moved to positive territory and the impact on the corporate sector would likely be limited. To some extent, markets may have gotten slightly excited with the comments as Governor Ueda said that it is too early to do exit stimulation, inflation trend below 2% and need to keep up easing. He also said "may not be at stage to emphasize exit". Our house view still expects both the YCC, NIRP regimes to be removed. USDJPY was last seen at 146.90 levels. Bearish momentum on daily chart intact while RSI is near oversold conditions. Support at 146.20 (38.2% fibo), 145 levels. Bias to sell rallies. Resistance at 147.50 (100 DMA), 148.30 (23.6% fibo retracement of Jul low to Nov double-top).
- **Gold. Consolidation.** XAU was a touch firmer overnight. Last at 2028 levels. Bullish momentum on daily chart faded but decline in RSI moderated. Consolidative trades likely. Support here at 2020 (yest low), 2011 (38.2% fibo retracement of Oct low to Dec high) and 1996 (21 DMA). Resistance at 2058 (23.6% fibo), 2070 levels. Notwithstanding the corrective pullback, we remained biased to buy dips as Fed is likely done with tightening for current cycle and we expect real rates to ease lower. These should continue to underpin the support for gold prices.

Daily Market Outlook

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- USDCNH. Mild Upside Risks.** USDCNH continued to inch higher amid broad USD rebound and in response, to lingering effects of Moody's outlook revision for Chinese sovereign bonds to negative. Pair was last at 7.17 levels. Daily momentum turned bullish but rise in RSI moderated. Slight risk to the upside but we are also watchful of potential *leaning against the wind* activities to restraint any excessive move to the upside. Resistance at 7.1760 (week's high), 7.1965 (21 DMA). Support at 7.1430 (200 DMA), 7.1120 (38.2% fibo retracement of 2023 low to high).
- USDSGD. Sell Rallies.** USDSGD firmed, in line with our caution. Pair was last at 1.3425 levels. Bullish momentum on daily chart intact but rise in RSI slows. Potential hanging man pattern could be formed – we watch price action for potential bearish reversal. Resistance at 1.3430 (21 DMA), 1.3470 (50% fibo, 200 DMA). Support at 1.34 (61.8% fibo retracement of Jul low to Oct high), 1.3320 levels. Pair is likely to take cues from USD and this hinges on US data, and there is quite a handful this week, including ADP employment, unit labour costs (Wed) and payrolls report, Uni of Michigan sentiment, inflation expectations (Fri). Softer than expected print can stall the USD rebound momentum.
- HKD rates.** The whole t/t swap curve was pushed up on Wednesday, while HKMA discount window was tapped at HKD3.47bn. The discount window is not often tapped – but now it is no longer a surprise, and it was a relatively big amount compared to pass usages. Given the low Aggregate Balance (interbank liquidity), front-end HKD rates shall stay sensitive to changes in liquidity demand even from a limited number of market participants. We expect front-end HKD rates to stay elevated through to year end with sporadic jumps. Further out at 3M tenor and beyond, HKD rates may retrace from elevated levels passing year-end, outperforming USD rates during the early part of 2024 before Fed starts to cut rate. We remain of the view that it is likely to be a downward trend for HKD rates on a multi-month horizon.
- CNY rates.** PBoC continued to withdraw liquidity via daily OMOs, at a net RMB300bn this morning. Repo-IRS opened mixed. Liquidity has stayed on the tight side with NCD rates edging further up. 12M rate for AA+ NCDs was last at 2.7691% versus 1Y MLF rate at 2.50%. We continue to see an RRR cut as likely; despite this expectation, we maintain a mild upward bias to RMB rates on prospects of resilient economic activities, while any liquidity injection is to buffer increased demand but not more. Back-end CNH points edged higher overnight despite the somewhat range-bound USD rates; multi-month bias is to the upside for back-end points on expected widening (less negative) in RMB-USD rates differentials; and we expect the FX swap curve to steepen albeit with potential return of short-term volatility at the very front-end.



Source: Bloomberg, OCBC Research

Global Markets Research & Strategy

Macro Research

Selena Ling

Head of Strategy & Research

LingSSSelena@ocbc.com

Tommy Xie Dongming

Head of Greater China Research

XieD@ocbc.com

Keung Ching (Cindy)

Hong Kong & Macau

cindyckung@ocbcwh.com

Herbert Wong

Hong Kong & Macau

herberthtwong@ocbcwh.com

Lavanya Venkateswaran

Senior ASEAN Economist

lavanvavenkateswaran@ocbc.com

Ahmad A Enver

ASEAN Economist

ahmad.enver@ocbc.com

Jonathan Ng

ASEAN Economist

JonathanNg4@ocbc.com

Ong Shu Yi

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

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