Daily Market Outlook

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Decision Day – the dots, the votes, and the balance of risks

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- **USD rates**. UST yields fell for a second day, with investors showing no appetite to pare dovish bets running into FOMC decision day. Reaction to the better-than-expected retail sales and higher import prices was short-lived. With Fed funds futures pricing in a total of 155bps of additional cuts in the cycle and 2Y UST yield at 3.5% level, the bar appears high for the Fed to out-dove the market. Meanwhile, a 10Y yield at 4.00-4.15% looks fair to us. Tonight's focus will be on the dot-plot (under the SEP which includes updates on growth, inflation and unemployment forecasts as well), the split of votes, and Powell's rhetoric on the balance of risks. Consensus is for the 2025 median dot to stay unchanged (i.e. pointing to one more cut after tonight's expected cut), and for the 2026 dot to move lower by 25bps; longer-run median dot is expected to stay unchanged at 3.000%. A lower 2025 median dot, discussion or a vote split involving a 50bp cut at this meeting, or Powell not balancing dovish bias at his press conference, may be seen as dovish. Meanwhile, some market watchers pay attention to the USD liquidity situation, with SOFR hitting 4.51% on Monday, which was above SRF rate of 4.50%. We maintain the view that bank reserves are likely to stay above USD3trn when US Treasury replenish cash position to target, but front-end funding rates may become a tad more sensitive as bank reserves move nearer to this USD3trn mark, especially when liquidity is unlikely to be evenly distributed among entities.

- **DXY**. Ahead of the FOMC meeting, the US Dollar weakened, with the DXY falling 0.69% on the day. This softness came despite stronger-than-expected US economic data: both retail sales and industrial production surprised to the upside, reinforcing expectations for a solid third quarter (Q3) US GDP print. Notably, Federal Reserve Bank of Atlanta's GDPNow upwardly revised its Q3 annualised growth estimate to 3.4%, from 3.1% previously. While a rate cut at tonight's FOMC meeting is widely viewed as a given, market attention will centre on two key elements: the dot-plot and the voting split among committee members. Resistance for the DXY sits at 97.40 and 98.10 (50 DMA). Support is at 96.40, 95.20 levels.

- **JPY**. Yen has strengthened following news that Minister Koizumi has been confirmed as a candidate in the LDP leadership race. He is widely viewed as a figure capable of driving generational change within the party and as a proponent of the BoJ policy normalisation efforts. Notably, during his tenure as agriculture minister, he took concrete steps to lower domestic rice prices. Regarding the BoJ, we expect the central bank to keep its policy rate unchanged at this week's meeting but view the October meeting as a live one at this juncture. Our view for USDJPY to trend lower is premised on a softer USD and Fed-BoJ policy divergence (Fed rate cut cycle to resume while the BoJ to continue its policy normalisation). Fed-BoJ policy divergence and USD diversification theme should still support USDJPY's broader direction of movement to the downside. Key levels to watch, resistance at 147.66 (50 DMA), 148.70 (200 DMA) and 149.40 levels. Support at 146.20 (50 DMA), 145.00.

- **GBP rates.** Before BoE MPC decision on Thursday, August CPI and RPI are scheduled to be released later today. Consensus is looking for a pick-up in headline CPI MoM, but some easing in core CPI YoY. Any upside surprise may further dent market expectation for additional rate cuts in this cycle. For this week's meeting, BoE is widely expected to keep its Bank Rate unchanged at 4.00%, which is also our call. The decision on QT pace for the next 12-month period starting October is also to be made. We expect BoE to slow QT pace, potentially to GBP60-80bn. A bigger reduction in QT pace to below GBP60bn will likely be seen as a positive surprise for medium to long-end gilts, which may render 10Y bond/swap spread stabilising around the levels of -55bps/-50bps.

- **HKD rates**. 3M HIBOR was fixed at 3.34310% on Tuesday, the highest since 7 May. Notwithstanding the known reasons for HKD liquidity tightness, we prefer to turn cautious and neutral HKD-USD rates spreads at current levels. First, a fair amount of dovishness is already reflected in USD OIS; some profit-taking flows at USD rates receivers post FOMC decision cannot be ruled out. Second, with spot t/t at current level and the softer USD bias, there is two-way risk in terms of potential FX intervention, although operations at either side do not look imminent. Third, on the other hand, inflows into HKD assets will prevent HKD liquidity from loosening materially. Month to date (16 September), net-buy under Southbound Stock Connect amounted to HKD105bn versus HKD112bn in the whole of August. On balance, we expect 3M HIBOR to settle around 3% level.

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