Daily Market Outlook

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Trade tensions; US heavy data week

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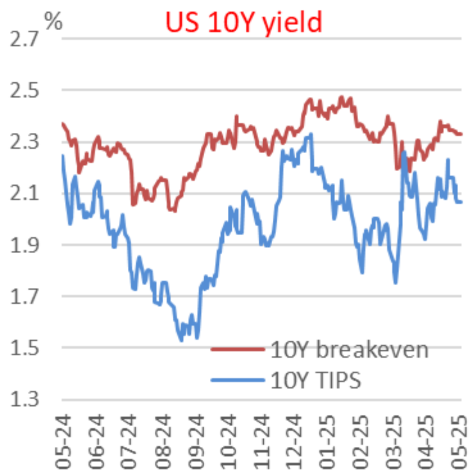
- **USD rates**. UST yields fell on Friday during NY hours to end the day a tad lower, on heightened trade tensions. Trump said to double tariffs on steel and aluminium to 50% from 25%, and he accused China of violating some of the agreements under the current trade truce – China MoF on Monday morning accused US of unilaterally introducing new discriminatory restrictions. Risk sentiment turned sour with Asian equities mostly down at open, but the small rallies in USTs have not been extended. On the data front, April PCE deflator and core PCE deflator printed mostly in line with expectations, showing mild disinflation progress. Personal spending slowed as expected. Recent survey/data mostly came in on the soft side, and investors will observe as to whether the soft economic backdrop is confirmed with this week's data, as triggers for rate cuts will likely need to come from the labour market/growth front when the FOMC remains mindful of inflation impact of tariffs. These include ISM manufacturing and services, JOLTS jobs data, ADP employment change, payrolls and other labour market statistics. Fed funds futures added mildly back to rate cut expectation, pricing 54bps of cuts for this year. There is no coupon bond auction this week, after last week's solid auctions; net coupon bond settlement is at USD94bn this week while bills paydown continues, at USD38bn as bill issuances are constrained by the debt ceiling. Near-term range for 10Y yield remains at 4.34-4.52%.

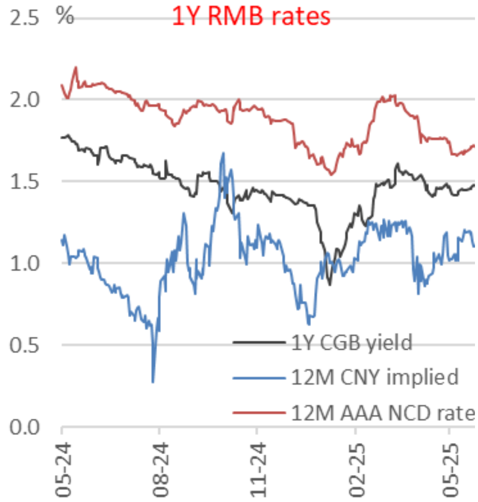


Source: Bloomberg, OCBC Research

- Fed's Waller laid out two tariff scenarios, in a prepared speech at the Bank of Korea International Conference. Under the large-tariff scenario, he expects PCE inflation to peak at 4-5%, and unemployment to rise to up to 5%. Under smaller-tariff scenario, he sees PCE inflation rising to 3%, and unemployment rate to rise but not to as high as 5%. Nevertheless, "whatever the size of the tariffs, [he] expects the effects on inflation to be temporary, and most apparent in the second half of 2025". Given his belief that any tariff-induced inflation will not be persistent and that inflation expectations are anchored, he supports "looking through any tariff effects on near term-inflation when setting the policy rate". This conclusion does not appear to represent the consensus among the Committee at this juncture, but any shift toward this thought process will add to the chance that the FOMC delivers additional Fed funds rate cut before year-end.

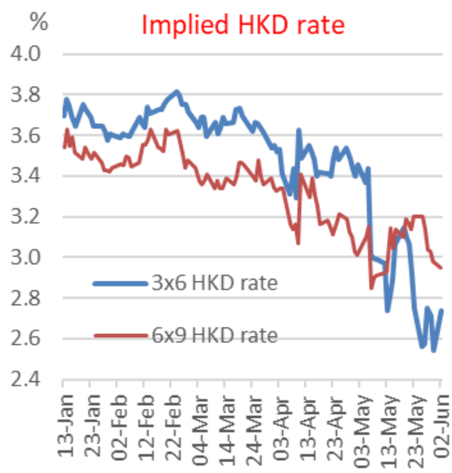
- **EUR rates**. Bund yields rose in response to German May CPI inflation which did not ease as much as expected. Bund yields retraced from intra-day high to end little changed, taking cue from UST market. EU harmonized CPI inflation for Germany eased to 0.2% MoM (consensus 0.1%) versus 0.5% MoM prior, or to 2.1% YoY (consensus 2.0%) versus 2.2% YoY prior. The inflation backdrop is nevertheless a benign one which supports further removal of policy restraint; ECB is widely expected to deliver another 25bp rate cut on Thursday. After this expected rate cut, interest rates are probably around neutral levels. Thereafter, the decision to be made is whether to have an outright easy policy to simulate growth – our base-case is for ECB to push its policy Deposit Facility Rate to 1.75%, i.e. additional 50bps of cuts including the expected cut for this week.

- **CNY rates**. Repo-IRS opened 1bp lower on Friday, while CGBs were stable. PBoC conducted PBoC conduced CNY700bn of outright reverse repos in May, comprising CNY400bn of 91-day tenor and CNY300bn of 182-day tenor, which was smaller than the maturity of CNY900bn in the month. Focus this month is the massive CNY4.16trn of NCDs which mature, together with the maturity of CNY1.2trn of outright reverse repos (CNY700bn of original 3M tenor and CNY500bn of original 6M tenor). NCD rates have been edging up over recent days, although still being below levels before the RRR and interest rate cuts. 1Y AAA NCD rate edged lower back to 1.70% level; 1Y implied CNY rate at 1.11% and 1Y implied CNH rate at 1.39%. While still viable pick-up at NCDs may render some support from inflows, PBoC liquidity support is probably needed.



Source: Bloomberg, OCBC Research

- **HKD rates.** Spot rose to a high of 7.8445 on Friday late afternoon, and was trading at 7.8418 as of writing, remining near the weak side convertibility undertaking of 7.8500. There has been some recovery in Southbound Stock Connect flows in recent days; but these flows together with dividend payment flows, appear not enough to more than offset the wide USD-HKD rates differentials, keeping an upward bias to spot. 1Y HKD IRS was paid up by 6bps this morning, against the mild drops in USD OIS, as investors are probably mindful of the risk of HKMA FX intervention which will drain HKD liquidity – we wrote that “as and when it happens, any reversal in HKD rates move can be rapid and forceful.” Forward implied 3x6 HKD rate was last at 2.74%, while implied 6x9 HKD rate was at 2.95%; these compared to 3M HIBOR fixing of 1.32286% on Friday.



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