# Daily Market Outlook

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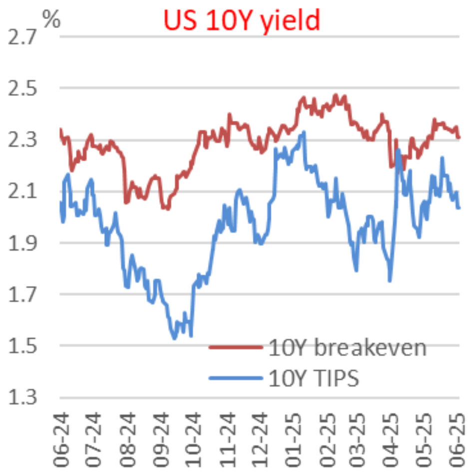
## Focus on US labour market and ECB decision

**Frances Cheung, CFA**
FX and Rates Strategy
**FrancesCheung@ocbc.com**

Global Markets Research and Strategy

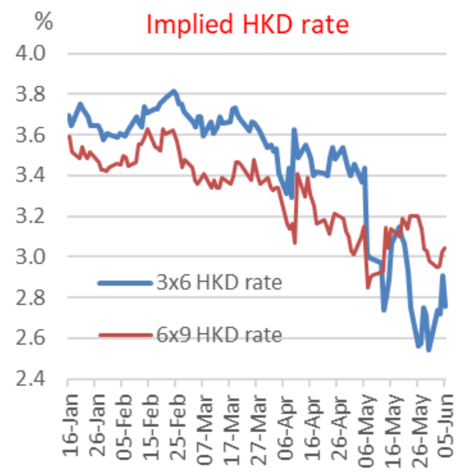
- **USD rates**. USTs rallied as ISM Services Index and ADP employment change printed weak, and market added to rate cuts expectations. ISM Services Index dipped to 49.9 in May, the first below-50 reading since June 2024; new orders was weaker at 46.4 while prices paid was up to 68.7, likely reflecting tariff impact. Although the employment component improved to 50.7 from 49.0 prior, it was overshadowed by the ADP employment change which was a meagre 37K in May versus expectation for 114K. We have been of the view that triggers for the next Fed funds rate cut likely need to come from the labour market (i.e. the growth front), given that FOMC members remain mindful of potential inflation impact of tariffs. Investors await Friday's nonfarm payrolls and other labour market statistics. Expectation for nonfarm payroll is again diverse, from 75K to 190K with median forecast of 126K as per Bloomberg survey. Key will be the conditions in sectors that had made more notable contributions to nonfarm payroll changes over the past months, including "education & health services", "trade, transportation &utilities" and "leisure & hospitality". 10Y UST yield was last at 4.37%, the low end of expected range and near our end-quarter forecast of 4.35%. 10Y real yield at around 2% level and 10Y breakeven at 2.3% level (not adding up to nominal yield as TIPS are not trading in Asia morning) do not look particularly rich for the bond; granted, there is likely to be a fair bit of market volatility around the labour market data releases tonight (jobless claims, unit labour costs, etc) and on Friday. Fed funds futures price 57bps of cuts for this year, with a 25bp cut by September FOMC fully priced.




Source: Bloomberg, OCBC Research

- **EUR rates**. Bund yields rose on Wednesday during early trading hours, as PMIs in the Eurozone mostly printed firmer than expected. Bunds nevertheless pared some of the earlier losses taking cue from the UST market. ECB is widely expected to deliver another 25bp rate cut later today, as the benign inflation backdrop – and adding in potential disinflationary impact of tariffs for the periods ahead – supports further removal of policy restraint. After this expected rate cut, interest rates are probably at 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. an additional 25bp cut after the expected cut today. Comments from ECB officials have largely turned more dovish recently, and investors will watch if Lagarde will shed any light on that shift in tone. EUR OIS price additional 56bps of cuts between now and year end, with the OIS curve exhibiting a deep V-shape, which appears dovish enough at this juncture.

- **HKD rates**. Spot USD/HKD rose to an intraday high of 7.8475 on Wednesday, just 25pips away from the weak side convertibility undertaking of 7.8500. After opening lower this morning on the back of the soft dollar, the pair is facing upward pressure again and was trading at 7.8458 as of writing. We wrote earlier that "while the wide USD-HKD rates differentials encourage carry trades, these flows do not necessarily dominate the market and there is a high uncertainty as to how long it takes to push spot to 7.8500 level." That said, as and when FX intervention on the weak side happens, any reversal in HKD rates move can be rapid – the pace of liquidity withdrawal under this scenario depends on market forces in the spot market. HKMA Discount Window was tapped at HKD3bn on Wednesday, somewhat surprising given the bigger size of the Aggregate Balance; we choose not to read too much into this usage, which was probably due to isolated demand. HKD IRS were offered down by 6-7bps at open, lagging the falls in USD OIS. Over recent days, short-end HKD-USD rate spreads have corrected mildly higher, and back-end forward points edged up alongside. We maintain our upward bias to short-end HKD-USD rate spreads. Forward implied HKD rates continued to trade at levels that are materially higher than HIBORs. Southbound Stock Connect flows recovered in recent days, registering net-buy for 6 days in a row.




Source: Bloomberg, OCBC Research

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## Macro Research


**Selena Ling**
Head of Research & Strategy
lingsselena@ocbc.com

**Tommy Xie Dongming**
Head of Asia Macro Research
xied@ocbc.com

**Keung Ching (Cindy)**
Hong Kong & Macau Economist
cindyckeung@ocbc.com

**Herbert Wong**
Hong Kong & Taiwan Economist
herberthtwong@ocbc.com

**Lavanya Venkateswaran**
Senior ASEAN Economist
lavanyavenkateswaran@ocbc.com

**Ahmad A Enver**
ASEAN Economist
ahmad.enver@ocbc.com

**Jonathan Ng**
ASEAN Economist
jonathanng4@ocbc.com

**Ong Shu Yi**
ESG Analyst
shuyiong1@ocbc.com


## FX/Rates Strategy


**Frances Cheung, CFA**
Head of FX & Rates Strategy
francescheung@ocbc.com

**Christopher Wong**
FX Strategist
christopherwong@ocbc.com


## Credit Research


**Andrew Wong**
Head of Credit Research
wongvkam@ocbc.com

**Ezien Hoo, CFA**
Credit Research Analyst
ezienhoo@ocbc.com

**Wong Hong Wei, CFA**
Credit Research Analyst
wonghongwei@ocbc.com

**Chin Meng Tee, CFA**
Credit Research Analyst
mengteechin@ocbc.com