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Interest Rates Thoughts

Bond sell-off intensified

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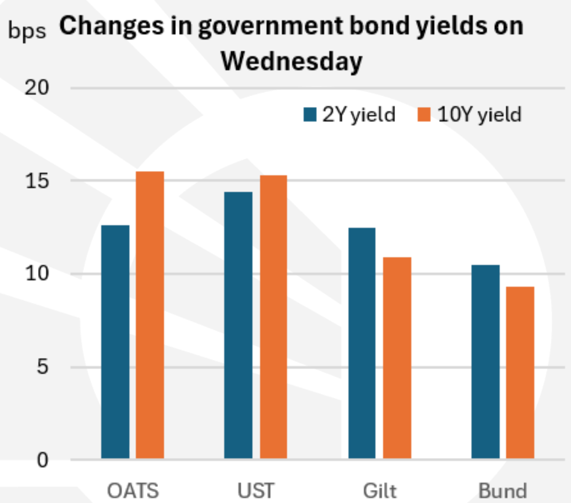
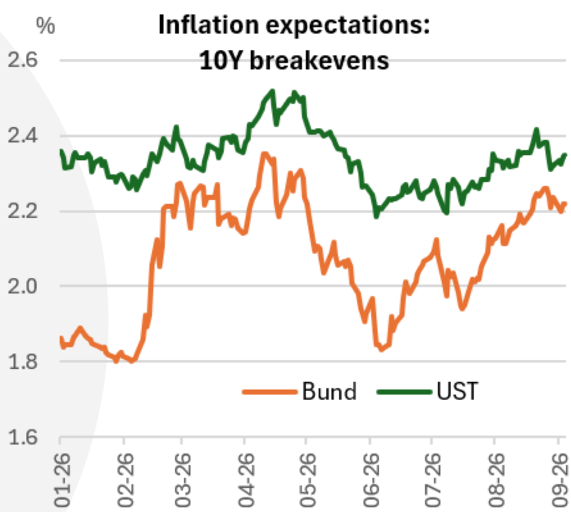
- **DM rates**. Sell-off in DM government bonds intensified on Wednesday, with USTs, gilts, bunds and other EGBs seeing yields notably higher, as oil prices rebounded with no sign of de-escalation in geopolitical tensions. This morning, ACGB yields rose by 8-10bps, taking cue from the global markets while Australia saw a higher-than-expected 39.5K employment gain in August. USTs underperformed bunds and gilts, with yields up by 15bps or more for most tenors, upon the surprisingly strong US PMIs (Europe PMIs also firmed up), which was followed by a weak 5Y coupon bond auction. US September manufacturing and services PMIs rose to 57.0 points and 58.7 points, respectively. Subcomponents showed strong employment and elevated input prices, which added to Fed rate hikes expectations. Fed funds futures last priced more than 90bps of hikes by end-2027, compared to the dot-plot for one 25bp hike.

- Overnight's 5Y coupon bond auction tailed by 3bps, despite the intra-day concession, with indirect accepted lower at 54.3% versus 61.5% prior, reflecting weak investor demand. Wednesday's uptick in 10Y UST yield was mainly driven by real yield which rose by 12bps reflecting the resilient economy, while breakeven rose by 3bps. Inflation expectation in the US have remained better anchored – which is good and bad as it could point to upside risk should energy prices stay elevated for longer. Tonight's 7Y coupon bond auction will be a gauge on whether there is a stabilization in investor sentiment.

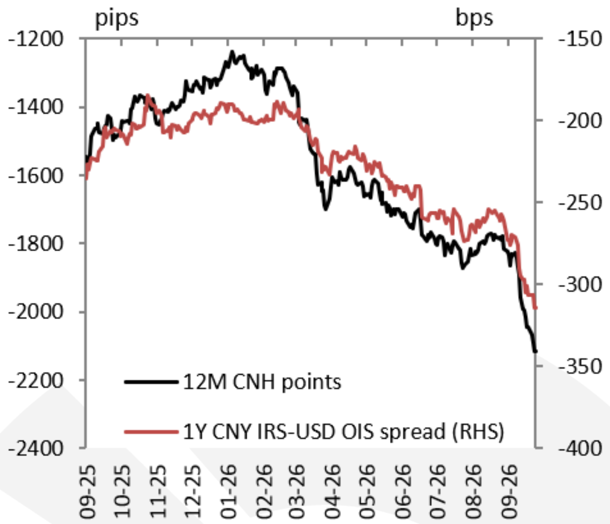


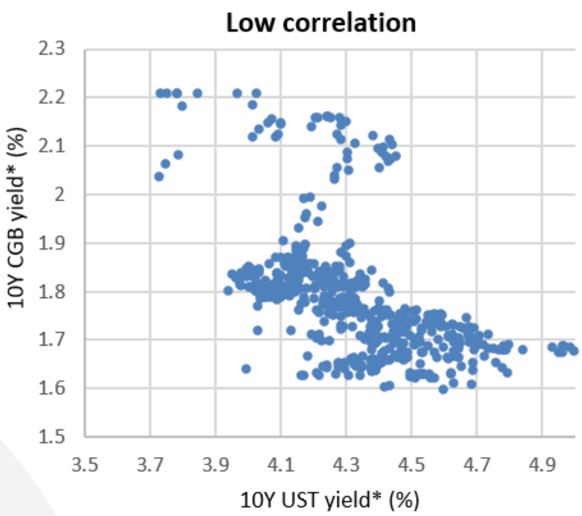


Source: Bloomberg, OCBC Group Research

- **CNY rates**. PBoC granted CNY800bn of 1Y MLF this morning, outsizing the CNY600bn of MLF that mature next week. Meanwhile, there was a net liquidity withdrawal of CNY110.5bn via 7-day reverse repos today. Overall, the liquidity condition is supportive. In the days ahead, PBoC is to conduct OMO overnight reverse repos on 28 Sep to 8 October. We had expected at least some of the liquidity provisions would be done via 14-day reverse repos. Now with up to CNY1trn of overnight reverse repos, it looks like PBoC will simply roll over the overnight instrument over the days through the holidays. It illustrates how an overnight instrument can be deployed to cover the liquidity demand during a longer period.

- Repo-IRS and CGBs have continued to trade within ranges, sustaining the domestic bond market's low correlation with the global bond market. Bias to CNY and CNH forward points remain to the downside, as CNY-USD rates differentials narrowed further (became more negative). In offshore, the 6M offshore PBoC bills garnered solid - but not overwhelming - demand with a bid/cover ratio of 2.12x, cutting off at 1.37%.



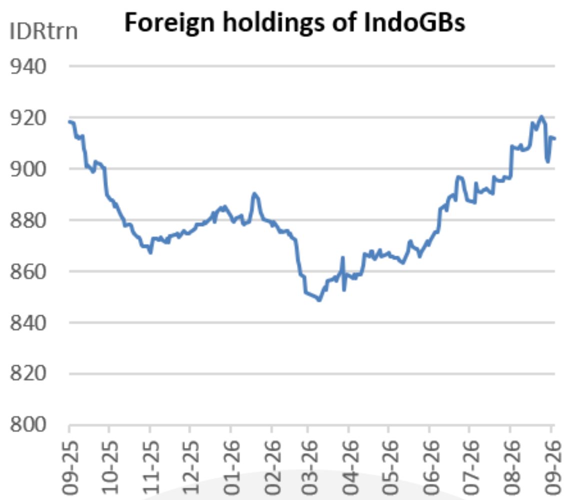


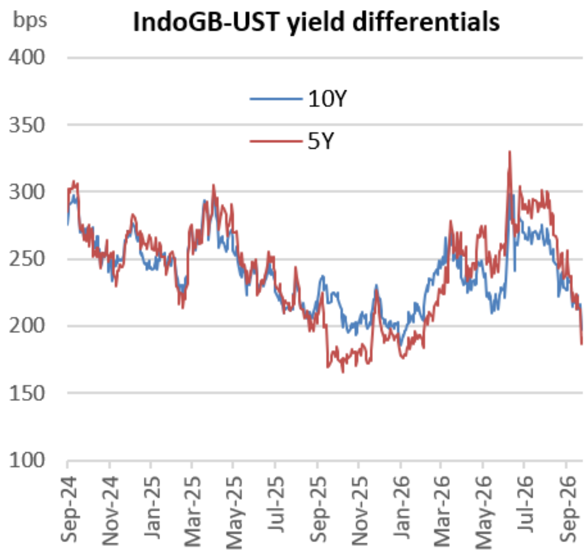
Source: Bloomberg, OCBC Group Research
*two years of data to 24 September

- **IDR rates**. IndoGBs rallied on Wednesday morning amid the risk-on sentiment, ahead of Bank Indonesia policy decision. While BI kept policy rate unchanged as widely expected, the central bank increased the incentives for foreign flows into IDR assets by further reducing FX hedging costs for underlying foreign funding transactions, including portfolio flows, foreign loans by banks and FDI . First, via FX swaps hedging, the premium reduction will be increased from 12.5% for all tenors, to 15% for 3-month tenors, 20% for 6-month tenors and 25% for 12-month tenors. Second, via

DNDF, the premium reduction will be increased from 15%, to 25% for a 6-month tenor and to 30% for a 12-month tenor.

- On bond flows, month-to-date (as of 21 September), foreign investors increased holdings of IndoGBs (including bills) by IDR4.3trn, despite the fall in outstanding amount. While IndoGB yields have retraced since the start of July, implied IDR rates have also mostly eased to sub-6% levels. The premium reduction on FX swaps will reduce the hedging costs by around 35bps for a 12M tenor, as per last market levels, adding to the pick-up at asset swaps into short-end IndoGBs. Although the incremental savings is not big, this may still point to a more constructive outlook for inflows into the short end. At the longer end, IndoGB-USTs yield differentials have narrowed notably since June; current yield spread levels are not particularly supportive of foreign inflows.





Source: Bloomberg, OCBC Group Research

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