Interest Rates Thoughts

Investors await buyback size and US CPI

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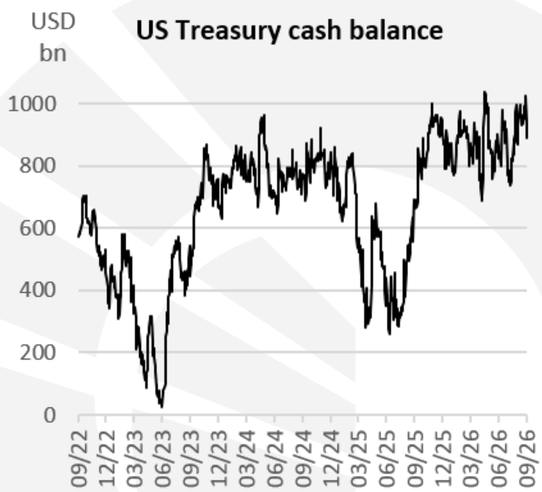
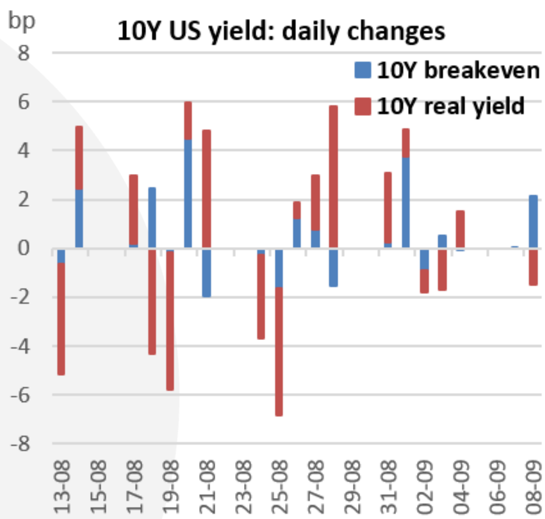
- **USD rates**. Short-end UST yields were up by 2-3bps while long-end yields were little changed overnight, reflecting muted reaction to higher oil prices. First, bond market pricings had already been hawkish while September FOMC decision remains a close call as investors await US CPI release. Second, the easing in JGB yields might also have provided some support at the margin. Third, US Treasury is to announce the size of buyback tonight, at least for the 10 September operation. The fall in 10Y real yield helped offset part of the increase in breakeven. Overnight's 3Y coupon auction went well, benefitting from outright yield level. Next is 10Y coupon bond auction tonight. Fed funds futures last priced a 64% chance of a 25bp hike at September meeting. Our base-case remains for a hold, although risk of a hike being delivered has risen – August CPI is key to watch. Consensus is for core CPI to come in at 0.2%MoM with the range of forecasts at 0.1-0.3%. As OCBC economists pointed out, a 0.3%MoM outcome would still mean three-month average of core CPI is contained. For the market, a 0.3% print is likely to keep the September FOMC as a close call, an above 0.3% print would add to the conviction for a hike, while a 0.2% or below outcome may see market pare back near-term rate hike expectations. Beyond the next policy decision, Fed funds futures pricing a total of 63bps of hikes by mid-2027 appears overly hawkish, so does 2Y UST yield at 4.4% level.

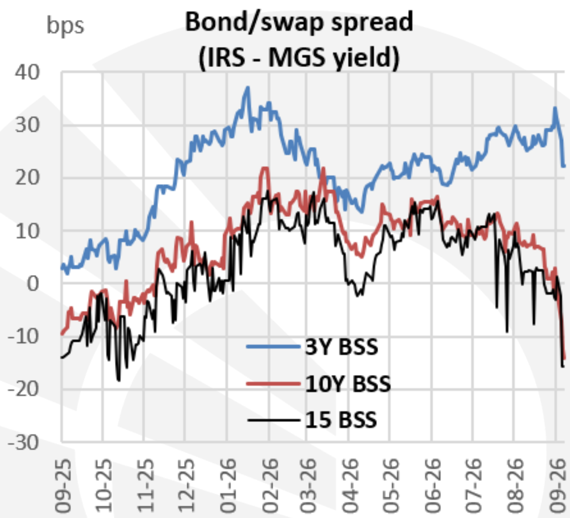


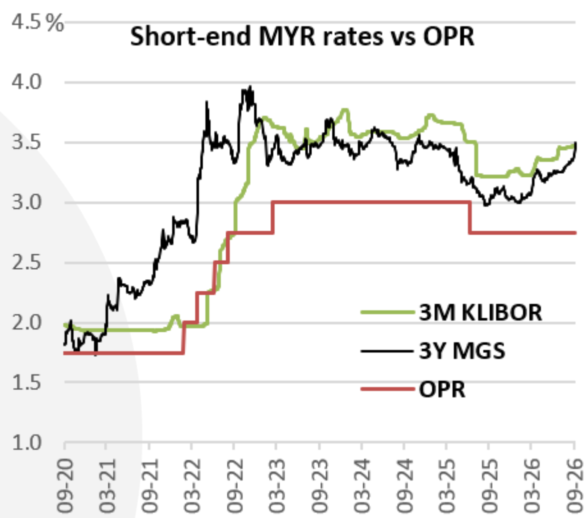


Source: Bloomberg, OCBC Group Research

- *US Treasury buybacks*. To recap, US Treasury has said it would at least double the buybacks at the 10-20Y and 20-30Y buckets; this would amount to USD14bn or more for the remainder of the 5 August – 4 November period. Bessent subsequently repeated the buybacks can be more. Each buyback size is USD2bn as per current schedule, hence investors eye USD4bn or above. To fund the additional buybacks, US Treasury can reduce buybacks of shorter tenor bonds/bills, or to tap their TGA balance. TGA balance was last at USD889bn on 4 September, but US Treasury has reduced the target to USD850bn for end-December. If they are to tap the cash, the balance needs to fall below 850bn, given current revenue and outlays estimates. There is still some room to do so albeit not as high as when the cash target was USD950bn. A fair expectation would probably be USD6-8bn per buyback.

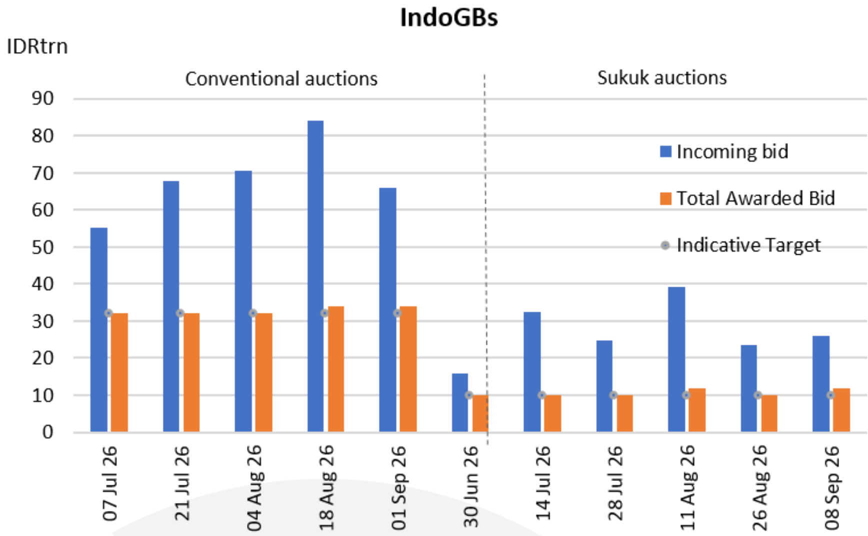
- **MYR rates**. Long-end MGS underperformed on the curve and against swaps. From the recent lows on 27 August, MGS yields had risen by cumulative 24-25bps across the 7Y to 20Y tenors, while 3Y yield was up by around 16bps, as of Tuesday. Swaps outperformed, with long end bond/swap spreads (IRS – MGS yield) having fallen to negative territory. 10Y bond/swap spread was last at -14bps, versus one-year average of +7.4bps; 15Y spread at -16bps versus one-year average of +3.2bps. The bond/swap spread valuation starts to look attractive, but investors may stay cautious for now. First, MGS had outperformed USTs for an extended period. While this reflects the stable nature of the domestic bonds, the wide yield spreads would slow bond recovery. Second, swaps themselves move. At the front end, an OPR hike is pretty much in the price, where the spread between 3Y MGS yield and OPR has widened further to above 70bps; this may help mitigate upside to the 3Y yield.





Source: Bloomberg, OCBC Group Research

- **IndoGBs.** Tuesday's sukuk auction drew incoming bid amount of IDR26.14trn, while IDR12trn of bills and bonds were awarded representing an upside against the target of IDR10trn. Among bonds, most of the incoming bids went to PBS30 (2028 sukuk) and PBS40 (2030 sukuk). As of 1 September, realization of issuances (including prefunding in 2026) amounted to IDR1163.59trn, of which 21.8% were from FX bonds. For Q3, quarter-to-date supply amounted to IDR228trn (including the 30 June auction with settlement on 2 July); with four upsized auctions in the quarter thus far, total grow issuances are on track to hit or come in mildly above target. Overall funding position is comfortable. On demand side, in the first five days of the month, banks, non-bank domestic investors and foreign investors all increased holdings of IndoGBs. Foreign holdings of IndoGBs stood at IDR915.66trn, or 13.03% of outstanding, as of 7 September. During August, foreign investors increased holdings in the >1-2Y and >5-10Y buckets, while reducing holdings in the >2-5Y bucket.



Source: DJPPR, OCBC Group Research

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