GLOBAL MARKETS RESEARCH

Interest Rates Monthly

11 March 2025

US yields in lower ranges

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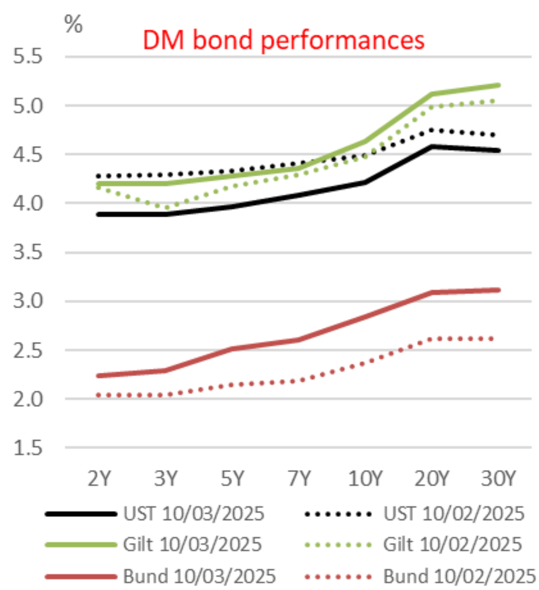
Global Markets Research and Strategy

- **USD rates**. UST yields have retraced from the peaks seen in mid-January to levels around our year-end targets. Markets have added to rate cut expectation, from being overly hawkish to a tad more dovish compared to our base-case for 75bps of cuts for this year. Yields have already moved onto lower levels and are likely to fluctuate within these lower ranges; catalysts are probably required to push yields back into higher ranges. Markets watch February CPI and March FOMC. Near-term downside to 10Y yield appears limited as long-term inflation expectation may be sticky at current level. Interim uptick in yields cannot be ruled out, but this may come as a correction, rather than a reversal to an extended uptrend in yields.

- **EUR rates**. There were a few less-dovish elements in the monetary policy statement and press conference, which suggest that the ECB Governing Council is contemplating the timing of a pause in rate cuts, as it gets near the end of the cycle. We hold onto our base-case for one more 25bp cut for this year. The recent movements in bond/swap spreads helped raise asset swap pick-up at Bunds especially at the long end, offsetting the earlier upward move in EUR basis. Long-end Bunds may start to find some support at current levels.

- **AUD rates.** RBA has adopted a balanced, if not hawkish, tone since the Board delivered the first 25bp cut in the current cycle. We have one 25bp cut left for this year in our forecast profile, and we hold onto this view for now. Risk is that we have to bring forward the 25bp cut we expect for 2026 to 2025. The rate-cutting cycle is still likely to be shallow.

- **SGD rates**. Front-end SGD rates have further outperformed USD rates amid flush SGD liquidity. For how long this flush liquidity condition will last is uncertain. Still, we see limited downside to 2Y and 3Y rates which are the low points on the SORA OIS curve. With the recent moves in bond/swap spreads, asset swap pick-up at SGS has improved; the 10s20s segment of the SGS curve has also steepened mildly over recent days, pointing to some relative value at 20Y SGS.



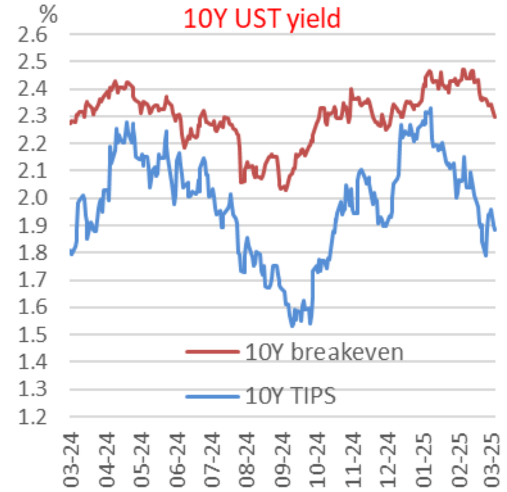
Source: Bloomberg, OCBC Research

USD:

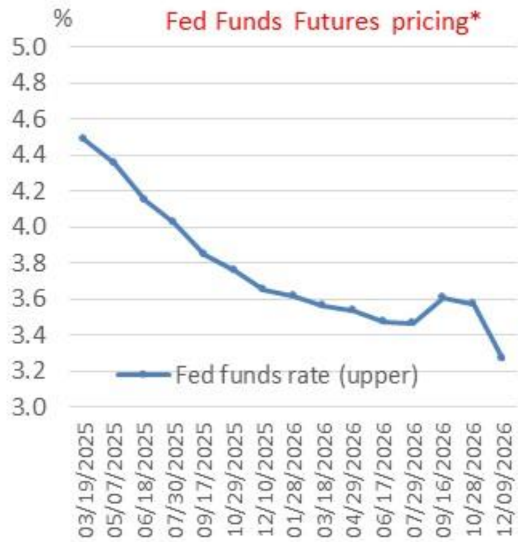
UST yields retraced from mid-January peaks amid growth concerns; falls in 10Y real yield explained around 70% of the move in 10Y nominal yield. Fed funds futures have added to rate cut expectations, last priced 85bps of cuts for this year and the terminal rate was seen at 3.30% (with reference to the upper end of Fed funds rate target range). Market pricings have turned from too hawkish to a tad more dovish compared to our base-case for 75bps of cuts this year and for the Fed funds rate (upper) to reach 3.50% by end-2026. After the recent bond rally, UST yields are mostly around our year-end targets (our year-end forecasts for 2Y yield at 3.85%, and 10Y yield at 4.15%). Yields have already moved onto lower levels and are **likely to fluctuate within these lower ranges; catalysts are probably required to push yields back into higher ranges. Interim uptick in yields cannot be ruled out, but this may come as a correction**, rather than a reversal to an extended uptrend in yields. While FOMC officials see no hurry to act and see the economy as fine or solid, growth concerns are likely to reverberate among investors.

Six-month average of non-farm payrolls was back up to a decent 191K (not incorporating all of government layoffs yet); but on the household survey, unemployment and underemployment rates both ticked higher when labour force participation fell; average hourly earnings was a tad softer (January and February combined); average weekly hours edged lower to 34.1 from an already low level. Powell believed official do not need to be in a hurry and “the cost of being cautious are very, very low”; Daly opined that the “FOMC has interest rates in a good place” and “there are plenty of signs that the economy is solid”. These comments reflect a push-back on near-term rate cut expectations. Further out, additional Fed funds rate cuts of up to 75bps do not require a recession scenario, in our view, as rates remain at restrictive levels.

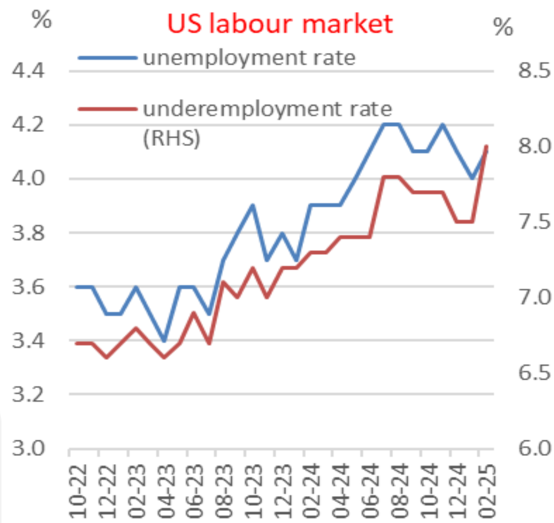
While we have been bullish rates, near-term downside to 10Y yield appears limited before additional data showing more weakness in the US economy. 10Y breakeven appears sticky downward at 2.3% area – level that we have seen as roughly consistent with long-term inflation target, while real yield will continue to fluctuate depending on incoming data. Near-term range in 10Y UST is seen at 4.10-4.30%, and a wider range is at 4.06-4.34%. We previously wrote “the dynamic on the curve may be changing, in that additional growth concerns may also be reflected at the short end, as market appears less reluctant to bring forward rate cut expectations” if data point to downside risk to growth. This has happened, with 2Y UST having played catch-up in rally



Source: Bloomberg, OCBC Research



Source: Bloomberg, OCBC Research *10 March 2025



Source: Bloomberg, OCBC Research

leading to a re-steepening of the UST curve. 2Y yield last at 3.85% was roughly in line with our Fed funds rate call.

March FOMC. February CPI/PPI will be released before March FOMC meeting. The CPI base effect is favourable for the months ahead in that given similar sequential price pressure, chance is for softer year-on-year inflation prints. The recent soft prints of retail sales and services PMIs may also suggest that the disinflation trend in core services has been extended. However, energy bills have become more expensive. On balance, we would be looking for a print of just below 3.0% YoY for February headline CPI. FOMC members are however unlikely to react to February CPI alone even if it did come in soft, given the January CPI outcome and their cautious approach. Our base-case is for one 25bp cut in each of Q2, Q3 and Q4-2025. The dot-plot will be updated at the March meeting. Until recent days, market expectation was for the median dot to move higher at the March update, but this outlook has since become uncertain, or less likely. FOMC members are unlikely to run ahead of the curve on either side. On balance, there is a fair chance that the median dot stays where it was, pointing to two cuts this year.

Source: Bloomberg, OCBC Research

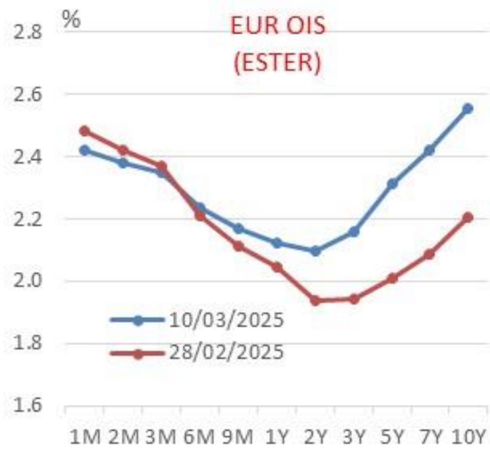
EUR:

ECB lowered the three key ECB interest rates by 25bps at the March meeting as widely expected. There were a few less-dovish elements in the monetary policy statement and press conference, which **suggest that the Governing Council is contemplating the timing of a pause in rate cuts, as it gets near the end of the cycle. We hold onto our base-case for one more 25bp cut for this year**. Market last priced 48bps of additional cuts for the rest of the year, with the chance of an April cut priced at 69%. These pricings appear overly dovish to us. On the March policy rate decision:

1/ The statement had it that "our monetary policy is becoming meaningfully less restrictive" – this was not an entire removal of the word "restrictive" but was still less dovish than the previous assessment that "monetary policy remains restrictive". Lagarde further explained that this change has a certain meaning, from a static assessment of what was needed to a more "evolutionary approach", taking into account of previous rate cuts.

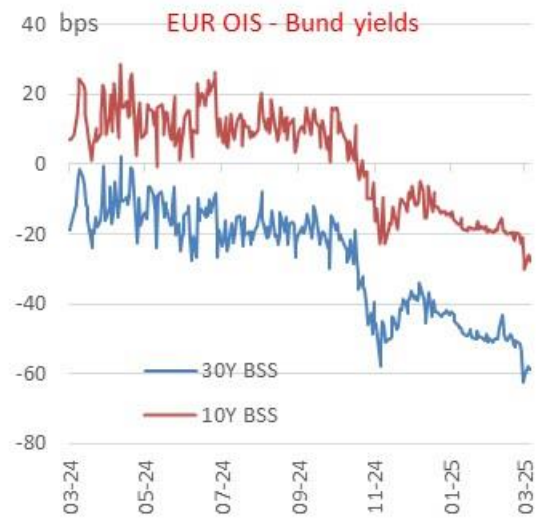
2/ When asked the question as to whether the direction is clear as there was no mentioning of "the direction of travel was clear", Lagarde did not give a definite answer but emphasised high uncertainty and commented the situation is not as straightforward – our interpretation is that the direction of travel is no longer clear.

3/ Lagarde revealed that while the rate cut decision was a consensus, one governor – Holzmann – abstained.



Source: Bloomberg, OCBC Research

4/ Lagarde mentioned yesterday's discussion was substantive, quite extensive, intense and lively. This suggests that there might be a higher diversity of views within the Governing Council than at previous meetings.



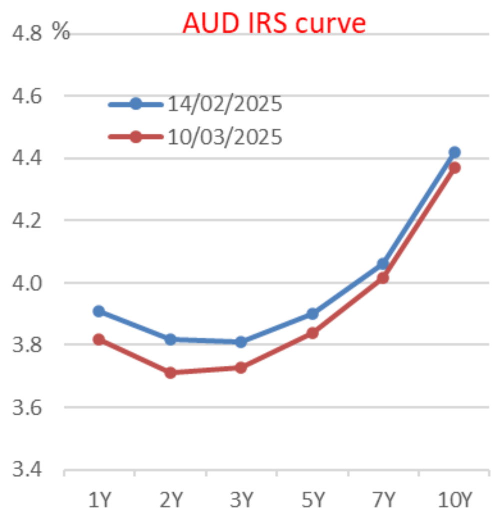
Source: Bloomberg, OCBC Research

Bunds underperformed major DM sovereign bonds upon the defence spending plan in EU - of EUR650bn on member states level over four years and EUR150bn as loans provided to member states, and infrastructure spending push in Germany. Long-end bond/swap spreads fell to below 2013/14 levels. On a more positive note, the recent movements in bond/swap spreads **helped raise asset swap pick-up at Bunds** especially at the long end, offsetting the earlier upward move in EUR basis. Long-end Bunds may start to find some support at current levels. This prospect, together with our less dovish ECB call, means we do not expect much further steepening in the curve near-term.

Interest rates forecasts	Q125	Q225	Q325	Q425
ECB Depo	2.50	2.25	2.25	2.25
1M EURIBOR	2.45	2.25	2.25	2.25
3M EURIBOR	2.55	2.30	2.30	2.30

AUD:

RBA has adopted a balanced, if not hawkish, tone since the Board delivered the first 25bp cut in the current cycle. The minutes for February meeting included arguments on both sides, for a hold and a cut – as per their usual style, but the elaborated arguments for a hold should not be ignored, in our view. Member opined "conditions in the labour market provided the strongest reason to leave the Cash Rate unchanged"; members considered "the easing in labour market conditions since late 2022 had at least stalled and may even have reversed a little in late 2024". Looking ahead, members observed that "not having lifted interest rates as high as in countries that had faced a similar inflation challenge meant the Board should be cautious when deciding to lower the cash rate". These opinions **underline our view that the rate cutting cycle in Australia is likely to be shallow** compared to major DM central banks that we monitor. We have one 25bp cut left for this year in our forecast profile, and we hold onto this view for now. **Risk is that we have to bring forward the 25bp cut we expect for 2026 to 2025**.



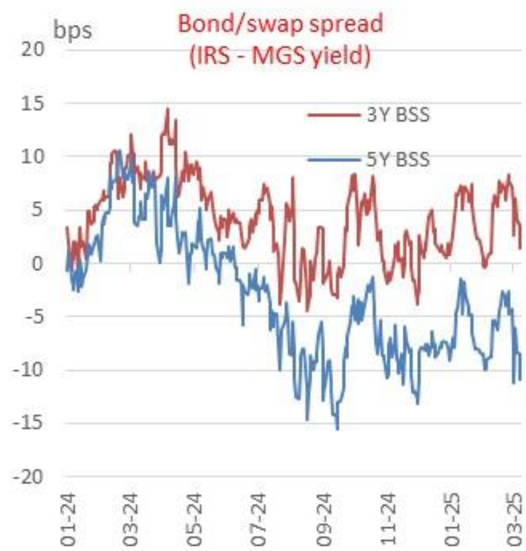
Source: Bloomberg, OCBC Research

Interest rates forecasts	Q125	Q225	Q325	Q425
RBA OCR	4.10	4.10	3.85	3.85
1M BBSW	4.10	4.15	3.90	3.90
3M BBSW	4.10	4.15	3.95	3.95

RBA projected underlying inflation will remain above the midpoint of the 2-3% range with assumption of Cash Rate at 3.60% for 2025 as implied by market pricings, at the time when the February forecasts were made. This suggests that the RBA may not be entirely comfortable with delivering additional 50bps of cuts. Market pricings have turned a bit more dovish since then. Cash Rate futures last priced additional 64bps of cuts for the rest of this year and no cut is priced for 2026.

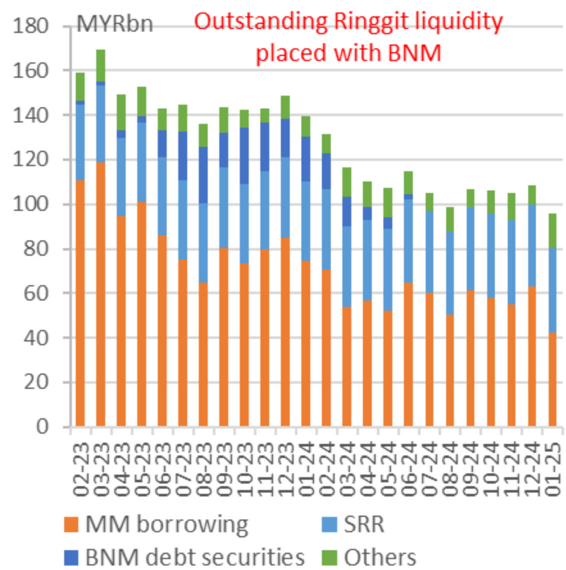
MYR:

MGS continued to trade in a stable manner, meaning underperformance against USTs upon the bond rally. Domestically, recent auctions were well received, with bid/cover ratios above 3.00x at the 5.5Y MGS and 15Y MGII sales. MGS underperformed swaps over the past couple of weeks, in line with our expectation as we recently wrote "IRS may be a bit more sensitive to any downward move in USD rates, given the stable nature of MGS". We are mostly neutral bond/swap spreads at current levels. There is duration supply ahead with 30Y MGII auction later this month; while there is maturity of MYR16.72bn on 14 March as a buffer.



Source: Bloomberg, OCBC Research

Outstanding Ringgit liquidity placed with BNM edged lower to MYR95bn at end January; our view has been that with this liquidity "settling at around the MYR100bn level versus higher levels in previous years, the spread between KLIBOR and OPR may not return to multi-year averages soon". 3M KLIBOR has stayed at 3.66% level, 56bps above OPR versus 5-year average of 47bps.



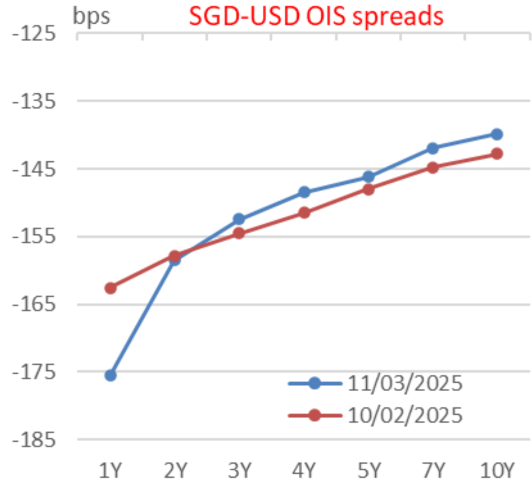
Source: CEIC, OCBC Research

Net issuances of MGS+MGII amounted to MYR34bn in the first two months of the year, while there was net bills paydown of MYR2bn – we have flagged that any change in outstanding bills is a swing factor to our full year gross MGS+MGII supply expectation of MYR163-164bn; for now, the amount of bills paydown is still within range. On demand side, EPF increased holdings by MYR14.3bn during Q4-2024. We continue to expect healthy demand for MGS/MGII from EPF on organic growth in contributions when MGS/MGII holdings as % share to total assets stays stable at least (been edging marginally higher). After EPF, banks and insurance companies absorbed most of the remaining supply in Q4-2024, while these onshore bonds saw foreign outflows in the quarter. January saw a reversal in bond flows, with the domestic market receiving almost MYR2bn in MGS+MGII.

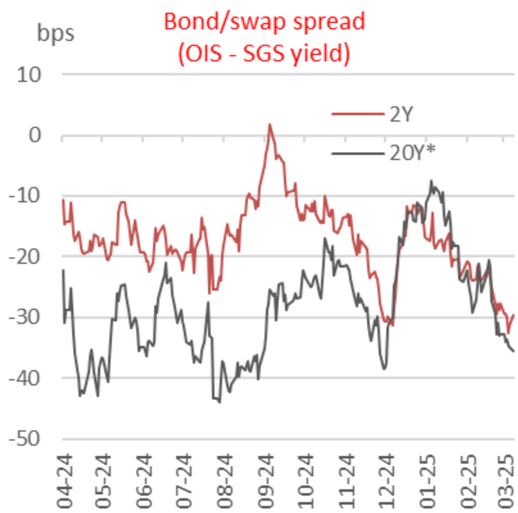
SGD:

Front-end SGD rates (1Y and below) have further outperformed USD rates over the past month, amid flush SGD liquidity. Further out the curve, movements in SGD OIS broadly followed those of USD OIS (the pass-through was already seen as high). Recent cut-offs at MAS bills and 6M T-bills came in lower mainly reflecting the lower implied SGD rates; cut-off spreads above implied SGD rates have stabilised at around 15-20bps for 4W and 12W MAS bills. Implied SGD rates have been falling steadily, as a result of lower USD rates and more negative forward points. This is notwithstanding the earlier reduction in the S$NEER slope by MAS; granted, the slope remains positive and there is room for S$NEER to move within the current band. For how long this flush liquidity condition will last is uncertain. Still, **on the SORA OIS curve, the 2Y and 3Y rates represent the low points**, at around 2.10-2.15% level, appearing to have incorporated the view for an extended period of flush liquidity; **we see limited downside to these rates** with risks of interim rebounds. Short-end SGD-USD OIS spreads are at very negative levels that deviate from historical pattern; we expect 1Y and 2Y SGD-USD OIS spreads to gradually turn less negative on a multi-month horizon.

SORA OIS have outperformed SGS, leading to lower (more negative) bond/swap spreads. With the recent moves in bond/swap spreads, **asset swap pick-up at SGS has generally improved,** to around SOFR+70bps (before bid/offer spreads) at 20Y SGS using 10Y hedge. The 10s20s segment of the SGS curve has also steepened mildly over recent days, pointing to some relative value at 20Y SGS, when there is no 20Y SGS auction this year. Next SGS auction is on 26 March of a new 5Y SGS (MD). Meanwhile, asset swap pick-up was around SOFR+60bps at 10Y SGS and 50bps at 5Y SGS.



Source: Bloomberg, OCBC Research



Source: Bloomberg, OCBC Research *20Y BSS for illustration purpose only

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