GLOBAL MARKETS RESEARCH

Interest Rates Monthly

23 May 2025

In focus: long-end yields; SGS outperformance; HKD rates

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Global Markets Research and Strategy

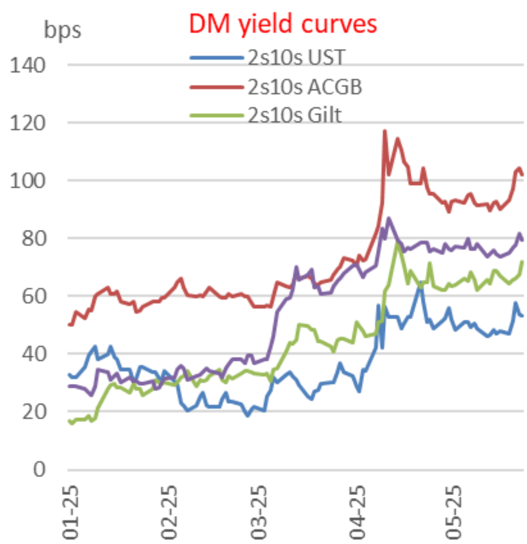
- **USD rates**. The term premium may be sticky downward as US fiscal position remains a concern for foreign investors likely leading to continued, gradual diversification away from USD assets. For domestic investors, USTs are still safe havens which may find some support at current yields and swap spreads levels. On balance, with potential supportive factors and in view of the growth impact of tariffs, we maintain a mild downward bias to USD yields amid domestic dynamics on a multi-month horizon.

- **JPY rates**. Long-end JGB yields have been rising steadily since the start of the month. Recent market performance and the gauge on demand for JGBs will be inputs to be weighed, ahead of BoJ's interim assessment of its QT plan in June. Our base-case is for BoJ to stick with its plan, but some shifts in allocation of reductions by remaining maturity cannot be ruled out.

- **AUD rates.** RBA cut OCR by 25bps at its May meeting as widely expected. The rhetoric turned out to be more dovish than expected. Given the bar for the RBA to ease monetary policy has turned lower, we are adding one more 25bp cut to our profile, now expecting additional 50bps of cuts for the rest of the year, which will bring OCR to 3.35% by year end.

- **SGD rates**. SGS have continued to outperform USTs. Being AAA-rated, SGS are likely to stay resilient in the face of higher US yields, in the absence of fiscal concerns and potentially benefiting from safe-haven flows. For USD-funded investors, asset swap-pick up is still attractive, while investors may even accept narrower spreads if diversification is the goal.

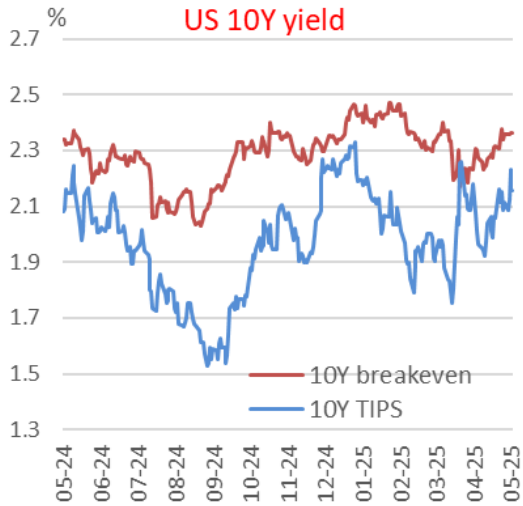
- **HKD rates**. HKD liquidity is likely to stay flush near-term, as the earlier injected liquidity remains in the system, unless there is FX intervention on the weak side of convertibility undertaking, or HKMA proactively shifts liquidity. That said, any reversal in short-end HKD rates move can be rapid and forceful, which is a risk that we remain mindful of.



Source: Bloomberg,OCBC Research

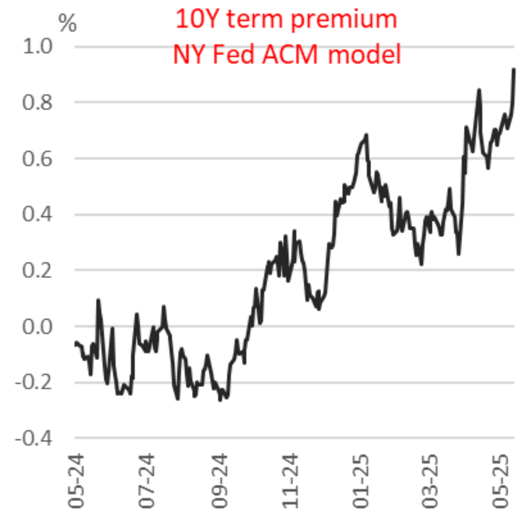
USD:

Investors may stay cautious at long-end USTs, awaiting the final decision on the US tax cut bill; this has kept the term premium high. US fiscal position remains a concern for foreign investors, but for domestic investors, USTs are still safe havens and diversion of flows from equities to bonds cannot be ruled out, given the high yields and swap spreads appearing supportive of bonds. 20Y swap spread was last at -83bps and 10Y swap spread has stabilised around -53bps. With supportive factors potentially coming through over the coming months, a neutral supply outlook and in view of the growth impact of tariffs, we maintain a mild downward bias to USD yields. The next level to watch for 10Y yield is at 4.35%.



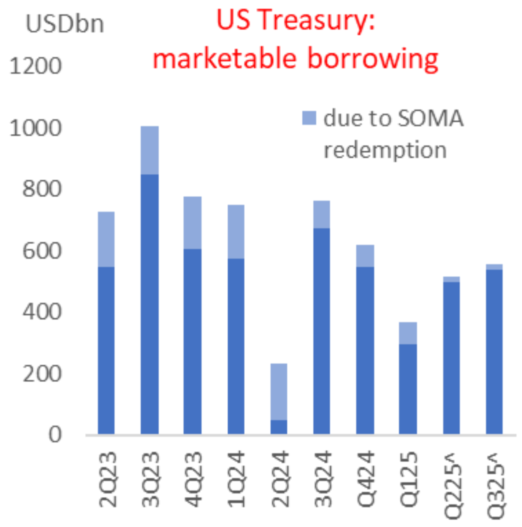
Source: Bloomberg, OCBC Research

Potential factors to watch. We await potential exemption of USTs from SLR calculation and a complete stop in QT. Exemption of USTs from SLR has been called for and under discussion for some time. Materialisation of such may help swap spreads to move higher. On QT, the pace has slowed since April. Although the decision at that time was understood to be in reaction to the debt ceiling issue, we suspect there may not be a re-acceleration in QT pace before a complete stop. The impact of slower QT pace is already reflected in US Treasury refunding plan – for Q1 and Q2 together, latest borrowing estimates are USD55bn lower than previous estimates, roughly equalling the USD60bn impact of the slower QT pace. There is still a final step to completely stop QT and even re-invest MBS redemptions into Treasury securities. The multi-month supply outlook is therefore neutral. We maintain a mild downward bias to US yields amid such domestic dynamics, but fiscal position remains a concern for foreign investors likely leading to continued gradual diversification away from USD assets.



Source: Bloomberg, OCBC Research

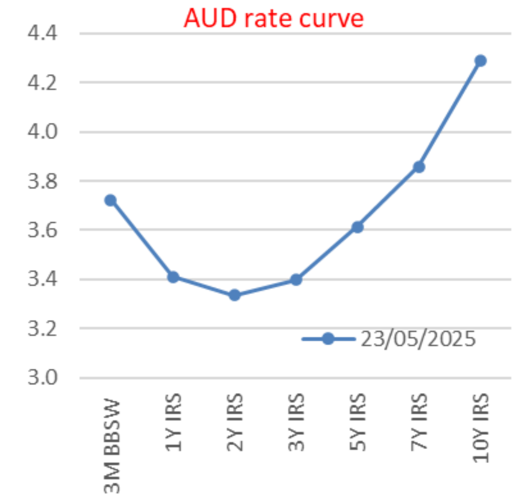
FOMC outlook. Triggers for rate cuts will likely need to come from the labour market/growth front; continued cooling in the labour market will justify rates at less restrictive levels if there is no strong rebound in inflation. Recent labour market indicators suggest the labour market is moving in line with gradual cooling. Our house view is for a US slowdown although we do not expect an outright recession in 2025. Our base-case remains for three 25bp Fed funds rate cuts this year, which does not require a recession macro backdrop. However, with the FOMC in no hurry to cut rates while the cooling in the labour market has been a slow process, we have pushed our expectation for the next Fed funds rate cut to Q3. We now expect one 25bp Fed funds rate cut in Q3 and two 25bp Fed funds rate cuts in Q4, instead of one 25bp cut each in Q2, Q3 and Q4. Incoming Fed official commentaries stuck with the stance of patience reflecting a wait-and-see mode.



Source: US Treasury, OCBC Research
^estimates by US Treasury

AUD:

RBA cut OCR by 25bps at its May meeting as widely expected. **The rhetoric turned out to be more dovish than expected.** ACGBs rallied by 12-16bps in a steepening manner; cash rate futures added to rate cut expectations, to additional 67bps for the rest of the year (versus 51bps prior, netting out the delivered rate cut). Dovish elements coming out of the 20 May decision included: 1/ Governor Bullock revealed a 50bp cut was discussed – although the strength of the argument for a 25bp cut was much bigger, while there was also discussion between a hold and a cut. 2/ The statement opined that "inflation is in the target band and upside risks appear to have diminished" – while understandably the commentaries needed to support the rate cut decision and hence by right would be more dovish than the previous statement, such opinion was still considered dovish. 3/ The Board has a scenarios analysis – considering a severe downside scenario and noted that "monetary policy is well placed to respond decisively"; while this is a scenario analysis, it nevertheless reflects the asymmetric risk that the Board sees.



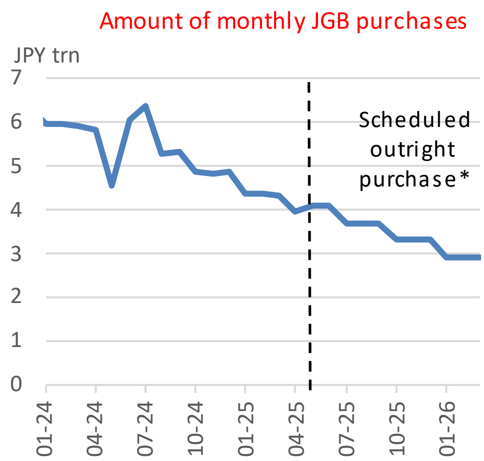
Source: Bloomberg, OCBC Research

Given that the bar for the RBA to ease monetary policy has turned lower, **we are adding one more 25bp cut to our profile, now expecting additional 50bps of cuts** for the rest of the year, which will bring OCR to 3.35% by year end. Cash rate futures futures pricing is more dovish at 69bps of additional rate cuts. 1Y to 3Y AUD IRS represent the low points on the interest rate cut; chasing these rates lower is not preferred.

Interest rates forecasts	Q225	Q325	Q425	Q126
RBA OCR	3.60	3.35	3.35	3.35
1M BBSW	3.60	3.40	3.40	3.40
3M BBSW	3.60	3.45	3.45	3.45

JPY:

Long-end JGB yields have been rising steadily since the start of the month. 30Y yield was up by cumulative 43bps (compared to 2 May low), 20Y yield up by 37bps and 10Y yield up by 26bps. The latest 20Y JGB auction did not go particularly well, adding to the selling momentum. Recent market performance and the gauge on demand for JGBs will be inputs to be weighed, ahead of BoJ's interim assessment of its QT plan in June. BoJ released the result of market participants survey on QT, where the responses were mostly on the hawkish side, but the survey was conducted on 1-9 May. Long-end yields have risen further since the time of the survey.



Source: CEIC, OCBC Research
*as per BoJ July 2024 plan

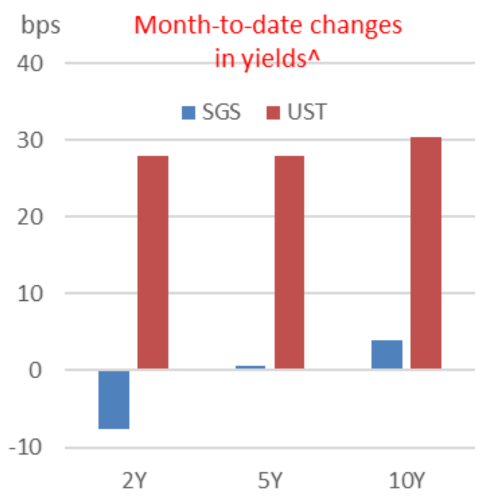
June BoJ meeting. To recap, according to the plan set out in July 2024, BoJ's monthly JGB purchase is on a step-down schedule by the quarter; Apr-Jun monthly purchases are set at JPY4.1trn (April actual was JPY3.95trn), to be reduced to 3.7trn/3.3trn/

2.9trn over the next three quarters. Our base-case is for BoJ to stick with this plan. Should the upward moves in long-end yields become more rapid, some shifts in allocation of reductions by remaining maturity cannot be ruled out.

Interest rates forecasts	Q225	Q325	Q425	Q126
BoJ Target rate	0.50	0.50	0.75	1.00
JPY TONAR	0.48	0.48	0.73	0.98
1M JPY TIBOR	0.60	0.65	0.85	1.10
3M JPY TIBOR	0.77	0.70	0.95	1.20

SGD:

SGS have continued to outperform USTs, by a wide margin in this latest upward move in US yields since the start of the month. Being AAA-rated, SGS are likely to stay resilient in the face of higher US yields, in the absence of fiscal concerns and potentially benefiting from safe-haven flows. For USD-funded investors, asset swap-pick up is decent, which was last at around SOFR+60bps (before bid/offer spreads) at 20Y SGS (at 10Y hedge), around SOFR+50bps at 10Y SGS, and around SOFR+40bps at 5Y SGS. These pick-ups are around or a tad below 1-year averages, while investors may even accept narrower spreads if diversification is the goal. Asset-swap pick-up has been usually wider further out the curve, because of the inverted SGD basis curve.



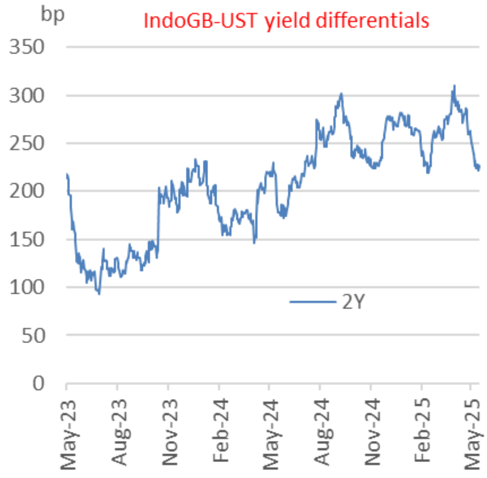
Source: Bloomberg, OCBC Research
^as of 23 May Asia afternoon

SGS have outperformed SGD OIS, in line with our view. SGD OIS themselves have rebounded from the recent lows, which was also in line with our expectations. On the curve, we continue to see the 2Y and 3Y rates as sweet spots for locking in funding costs. T-bill cut-offs, on the other hand, has continued with the downward trend, with spread between cut-off and implied SGD interest rates having narrowed mildly, reflecting strong investor demand. Next coming up are 5Y SGS (reopened) auction and 10Y SGS (non-benchmark) mini auction. The size of the 5Y SGS (reopened) has been announced at SGD2.6bn with MAS intending to take SGD300mn, which is within expected range. The size of the mini auction is at SGD900mn. Full-year gross issuances are well on track with our estimate of SGD26-27bn.

IDR:

IndoGBs have outperformed USTs thus far this month, as US yields rose on idiosyncratic factors and IndoGBs did not follow. After recent IndoGB outperformance, 10Y IndoGB-UST yield spread has narrowed to the low end of the 240-250bp area which we have seen as supportive of the domestic bonds but not a particularly attractive level. **We prefer shorter duration, with 2Y IndoGB-UST yield spread still relatively wide compared to 2-year history, and given the benign monetary policy outlook.** Our house view is for one more 25bp policy rate cut for the remainder of the year.

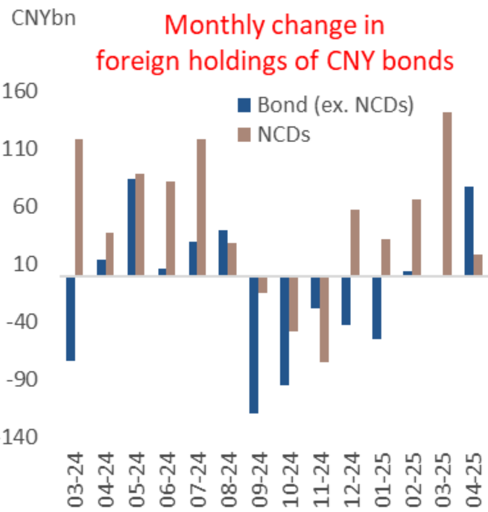
There have been upsizes at recent IndoGB auctions upon strong demand. Quarter-to-date gross issuance amounts (conventional + sukuk) were IDR120trn, ahead of the quarterly target of IDR190trn as there are still three conventional and three sukuk auctions left for the quarter. In particular, the latest conventional bond auctions on 20 May garnered a whopping incoming bid amount of IDR108trn – the biggest amount this year thus far, with most of the incoming bids having gone to the 5Y (FR104) and 10Y (FR103) bonds as usual. Foreign holdings of IndoGBs have been edging higher since the start of the month, standing at IDR909trn as of 21 May reflecting IDR9.8trn of inflows this month thus far. Demand from non-bank domestic investors and from the central bank has been supportive as well.



Source: Bloomberg, OCBC Research

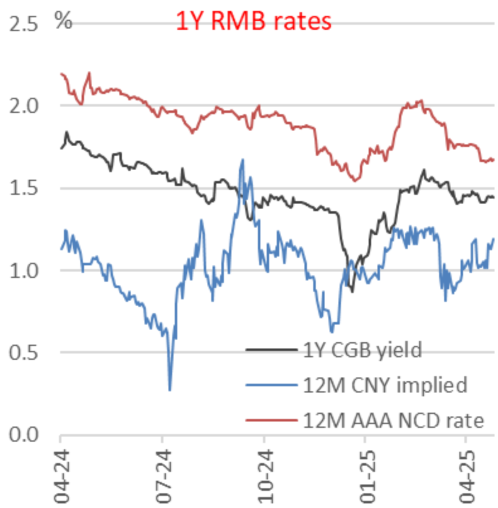
CNY:

Recent special CGB auctions were mostly well received – except the 50Y special CGB which saw a higher cut-off. The monetary policy backdrop is supportive with the latest RRR cuts and interest rates cuts; but the cuts had been expected while the somewhat tight CNY liquidity has prevented short-end CNY rates from falling. These recent performances have kept the CGB curve relatively flat. In response to the relatively tight liquidity situation, PBoC net injected liquidity via daily OMOs on the week of 19 May totalling CNY460bn. PBoC also granted CNY500bn of 1Y MLF in the month, against maturity of CNY125bn, representing a third month of net MLF liquidity injection. Looking ahead, we have a medium-term steepening bias on the CGB curve. First, 2Y bond/swap spread (repo-IRS minus CGB yield) recently hovered around par, after the rapid downward moves earlier in the year. Current level of the bond/swap spread is supportive of bonds; short-end bond yields are likely to stay anchored, or there is room for yields to edge lower upon further easing. Second, supply of special CGBs continues to come, with fiscal stimulus adding to the growth prospects.



Source: CEIC, OCBC Research

Bond and FX flows. Onshore CNY bonds saw inflows of CNY67bn in April with CNY49bn going into CGBs; inflows to CGBs were the biggest since Dec 2023. CGBs have probably benefited from some diversification of flows while foreign holdings are on the low side after earlier months of outflow (foreign holdings of CGBs to outstanding stood at 5.9% at end April). Inflows into NCDs slowed to CNY18bn from the whopping CNY141bn in March. Asset swap pick-up at NCDs has narrowed somewhat but may still be seen as viable as part of a portfolio – investors may be willing to accept a narrower pick-up if they would like to diversify; AAA rated 1Y NCD rate was last at 1.69% vs 1Y implied CNY rate at 1.17%. Meanwhile, FX flows to China were also positive in April, with receipts mainly through trade in goods. Net FX settlement by banks on behalf of clients was a positive USD6bn in April. Willingness to covert foreign currency receipt

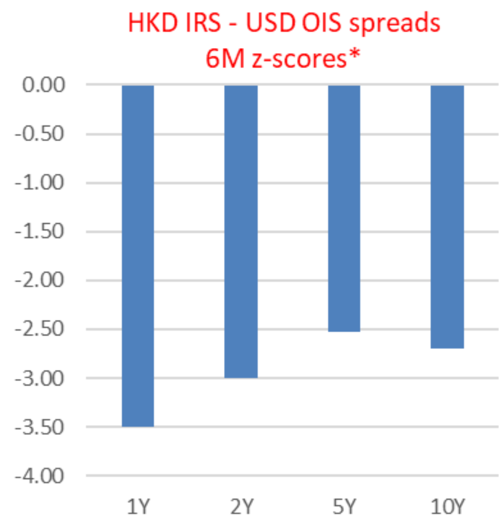


Source: Bloomberg, OCBC Research

into RMB recovered further to 64.4% (from a low of 54.4% in February and then 57.5% in March), reflecting improved RMB sentiment. From here, prospects remain for continued recovery in flows.

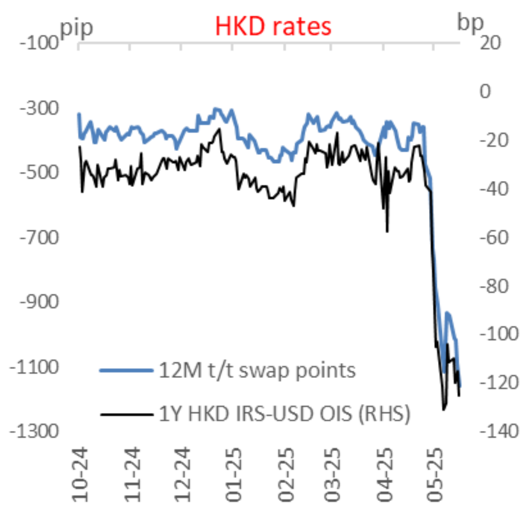
HKD:

Strong side convertibility of undertaking was triggered earlier in the month, which prompted HKMA to intervene by buying USD from the market, thereby injecting HKD liquidity into the interbank market. Aggregate Balance (interbank HKD liquidity) rose to above HKD170bn, after staying at around HKD40-45bn levels for an extended period. HIBORs were subsequently fixed materially lower and HKD IRS slid. Equity inflows coincidently slowed a lot since FX intervention, which has added to HKD liquidity flushness.



Source: Bloomberg, OCBC Research
*23 May Asia morning

Upon the plunges in HKD rates, HKD IRS – USD OIS spreads fell further to deeply negative levels. 1Y HKD IRS-USD OIS spread was last at -132bps, being 3.5 standard deviation below 6-month average. Back-end t/t swap points fell alongside rates differential; while forward outright levels may appear somewhat stretched, implied HKD basis are still within ranges although being on the low side; that is to say, the uncovered part of the interest rate parity is not too much out of line.



Source: Bloomberg, OCBC Research

HKD liquidity is likely to stay flush near-term, as the earlier injected liquidity remains in the system. Under the currency board system, liquidity will remain in the interbank market **unless 1/ there is FX intervention on the weak side of convertibility undertaking (7.8500), or 2/ HKMA proactively shifts liquidity** from interbank bank to the bills market (it has had tendency to do so upon demand for bills, with a time lag). On 1/, 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 it happens, any reversal in HKD rates move can be rapid and forceful, which is a risk that we remain mindful of.

On a multi-month horizon, we maintain an upward bias to HKD IRS – USD OIS spreads, on lower USD rate view, potential tighter (less flush) HKD liquidity conditions, and as a partial normalisation in the spreads. Apart from weak side being triggered, potential factors leading to higher HIBORs and short-end HKD rates include additional dividend payout activities, return of equity inflows, and recovery in HKD loan demand. HIBORs can potentially normalise back to the 2.5-3.0% area, but the timing is highly uncertain.

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