Interest Rates Monthly

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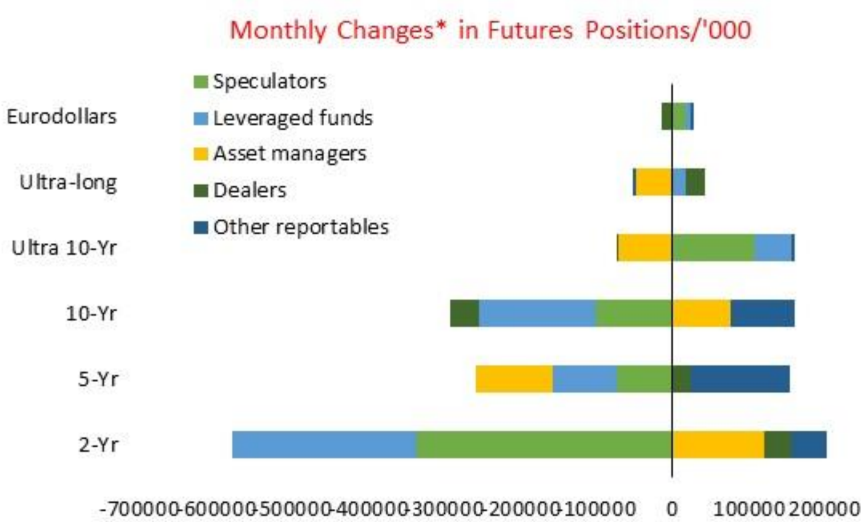
FOMC; T-bills supply

- **USD rates**. We remain of the view that the FOMC can afford to pause at the June MPC meeting, while assessing impact of past tightening on inflation, especially when the FOMC members themselves see high uncertainty on both the inflation and policy rate outlook. Rates at restrictive levels shall continue to work their way through to combating inflation pressure even without additional rate hike. The 2Y UST yield has fluctuated alongside changing rate hike/cut expectations. As market expectation has already adjusted, we now see a higher trading range for the 2Y UST yield, mostly at 4.20-4.50%.

- **GBP rates**. We expect the BoE to deliver a 25bp hike at the June MPC meeting. Gilts underperformed USTs in May, extending the YTD underperformance which has been our call for the first half of the year. The 1Y and 2Y bond/swap spreads have been fairly stable while OIS pricing looks overly hawkish to us. As such, we expect some stabilization in short-end UST-Gilt yield differentials from here.

- **SGD rates**. SGD-USD rate spreads have become more negative as USD rates rose more rapidly and the tendency has been that SGD rates outperformed USD rates on an uptrend. SGD-USD rate differentials look overly negative but some stabilization in USD rates is needed for the momentum to reverse. SGS outperformed SGD OIS in May in line with our expectations; there may still be some room for SGS outperformance over OIS.

- **CNY rates**. Our medium-term higher CNY rate view did not pan out as economic recovery has not come as strong; we have turned neutral CNY rates near term with CNY rates likely trading in the lowered ranges. A strong comeback of bond inflows is not on the horizon yet given unfavourable yield differentials. Lowered repo-IRS mean lower floors to offshore CNH rates as well.



Source: CFTC data via Bloomberg, OCBC Research, *as of 30 May

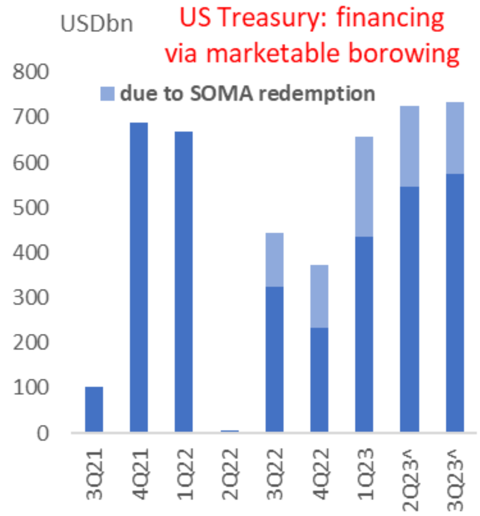
USD:

Over the past month, market has pushed up Fed funds rate expectations, now pricing in around a 70-80% chance of a 25bp hike by the July FOMC meeting, and around one cut thereafter. Factors that have led to this repricing higher include recent Fed commentaries and the May FOMC minutes which revealed that a pause is not a done deal, and firmer than expected economic data. Market's year-end expectation has become more in line with our base case, with a slightly different profile from ours – we expect no more hike and no rate cut this year, i.e. we expect the Fed funds rate target range to stay at 5.00-5.25% through to year-end. Market pricing has also moved towards the 150bps of cuts we have penciled in for 2024.

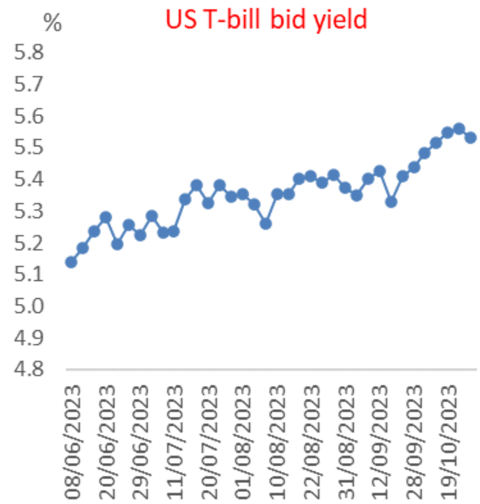
The 2Y UST yield has mostly fluctuated alongside changing rate hike/cut expectations. Our Fed funds rate profile is consistent with a 2Y yield at around 4.30-4.40% - we had previously put a trading range at 3.80-4.30% because we did not expect market to turn hawkish quickly. As market expectation has already adjusted, we now see a higher range for the 2Y UST yield, mostly at 4.20-4.50%. While there is upside to the yield if term premium goes higher and market tends to overshoot/undershoot, 2Y UST trading at a yield above 4.50% may start to attract some buying flows, or a reversal of flows - in the four weeks to 30 May, leveraged funds and speculators added to short futures positions at the 2Y.

FOMC preview. We remain of the view that the FOMC can afford to pause at the June MPC meeting, while assessing impact of past tightening on inflation, especially when the FOMC members themselves see high uncertainty on both the inflation and policy rate outlook. Rates at restrictive levels shall continue to work their way through to combating inflation pressure even without additional rate hike. The key, however, is to manage policy rate and hence inflation expectation through the notion that "a pause is not necessarily an end". If this notion gains traction in driving market expectations, it would then be an easier decision for the Committee to pause. The latest FOMC minutes illustrated how participants see "the importance and various aspects of clearly explaining monetary policy actions and strategy". We tend to interpret hawkish remarks as reflecting the aim to prevent the market from becoming overly dovish in case the FOMC decides to pause.

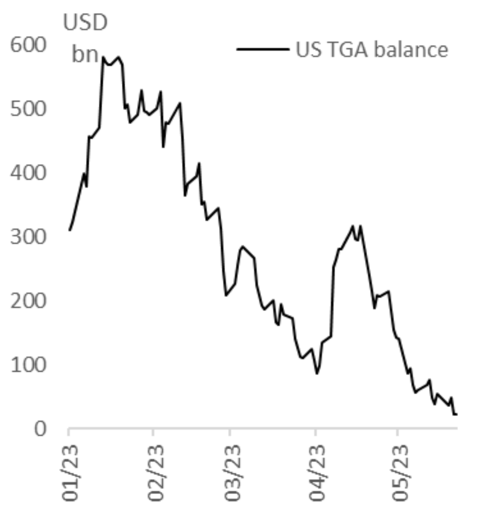
T-bills supply. The T-bill yield curve had steepened in anticipation of a debt ceiling deal. The reaction was in line with our expectation – we have been of the view that as and when the debt ceiling issue is resolved, **"**the T-bill yield curve, which is deeply inverted now, is likely to normalize/steepen as supply comes alongside an increase in the debt ceiling". Looking ahead, US Treasury is likely to look to replenish its cash position. Treasury's quarterly refunding plan has an estimate of its cash balance at USD550bn by end-Q2 and



Source: US Treasury, OCBC Research

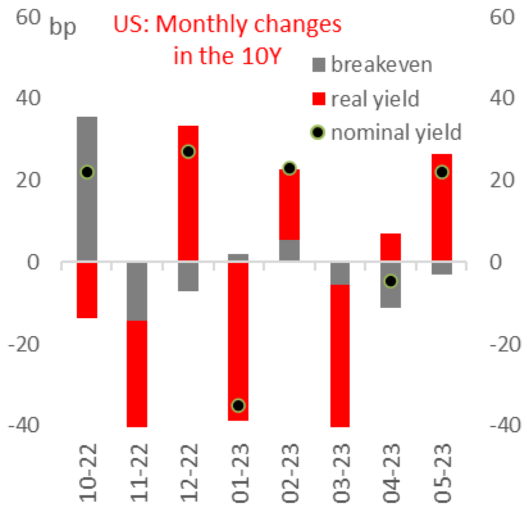


Source: Bloomberg, OCBC Research



Source: Bloomberg, OCBC Research

USD600bn by end-Q3. Net bill issuance this quarter to 2 June was USD14.2bn versus target of USD478.6bn for Q2, hence there is a catch-up of USD464.4bn to play (including USD89bn this week). **We however do not expect material upward impact on bill yields**: 1/ these issuances shall not be seen as entirely "extra"; they represent delayed supply – there have been hundreds of billions of supply each quarter (net bill supply has been planned at USD554.6bn for Q4, which appears on the high side), although there will be some implication on liquidity as supply concentrates over a shorter period of time; 2/ on this, we suspect the rebuilding of cash will be paced out through to end Q3, and the cash target may be adjusted lower; 3/ and with bill yields at above 5% now, there is a fair chance that some funds will be mobilized from the Fed's reverse repos mitigating the impact on liquidity, assuming the FOMC does not hike this administered rate this month.

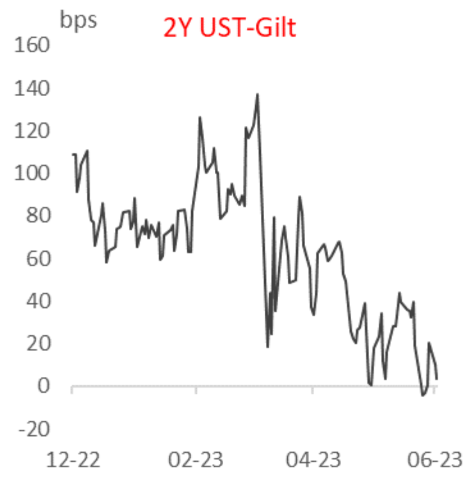


Source: Bloomberg, OCBC Research

Meanwhile, UST issuances have been on track with the quarterly plan, with a net USD125bn to go this month. USTs shall be mostly driven by macro themes – Fed funds rate hike/cut prospect against the backdrop of inflation and labour market development. Also, bond yields did not appear to be affected much on a sustained basis in past episodes of debt ceiling issues.

GBP:

UK April inflation came in higher than expected on both headline and core readings. YoY inflation in electricity/gas, and in household items decelerated as expected; but then upside came from a number of items including alcoholic beverage & tobacco, transport and communications, and recreation and culture. Core inflation accelerated to 6.8% YoY. Hence, the evidence that the BoE is looking for, in order to "rest" is not there yet. We now expect the BoE to deliver a 25bp hike at the June MPC meeting. Gilts underperformed USTs in May, extending the YTD underperformance which has been our call for the first half of the year. The 1Y and 2Y bond/swap spreads have been fairly stable while OIS pricing of BoE rate hike looks overly hawkish to us. As such, we **expect some stabilization in short-end UST-Gilt yield differentials from here**.



Source: Bloomberg, OCBC Research

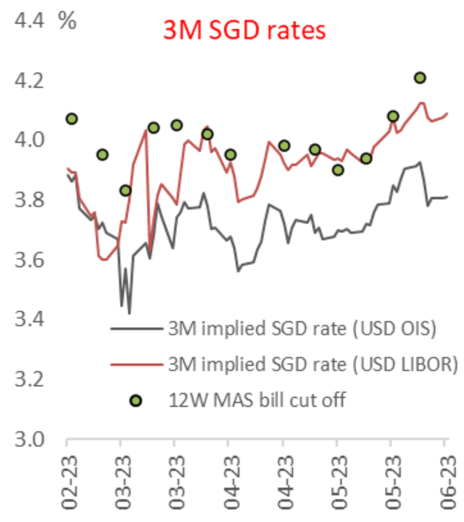
SGD:

SGD liquidity has turned tighter, as reflected by higher front-end rates including SORA itself and the cut-offs at recent MAS bill auctions. Liquidity tightness was extended from the 4W tenor to the 12W tenor of late. The 4W and 12W MAS bills auctioned on 30 May both cut off at a relatively high level of 4.21%; at the 23 May auction the cut-offs for the 4W and 12W bills were at 4.22% and 4.08% respectively.

At 6M and beyond, however, SGD-USD rate spreads have become more negative as USD rates rose more rapidly and the tendency has been that SGD rates outperformed USD rates on an uptrend. **SGD-**

USD rate differentials look overly negative but at least some stabilization in USD rates is needed for the differentials to turn less negative. In terms of levels, we expect SGD OIS to rise mildly from here, and to stay mostly stable through Q3, before easing towards year-end and more so in 2024.

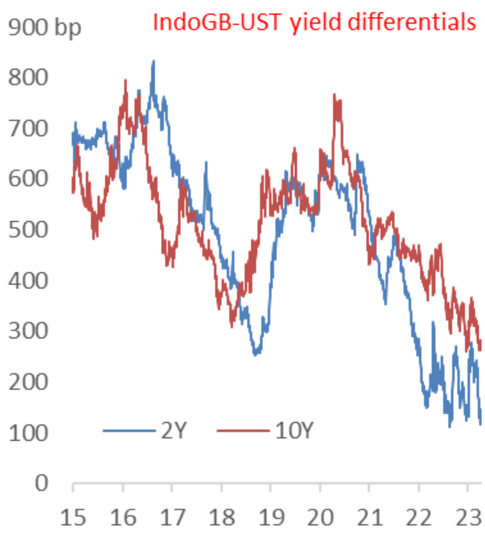
On SGS, the 5Y re-opening (maturing on 1 Nov 2026, non-benchmark) on 29 May cut off at 3.19%, similar to what was traded a day before, an improvement from some of the previous SGS auctions which tailed. The size of the auction was relatively small at SGD2bn with MAS taking SGD300mn contributing to the solid outcome. Also, following market feedback from primary dealers, MAS will not be holding a mini-auction on 27 June, which shall be supportive of SGS. SGS outperformed OIS in May in line with our expectations; there may still be some room for SGS outperformance over OIS. The 10s15s segment of the SGS curve may stay mildly inverted given demand for longer tenor bonds, while market awaits the announcement on 20 June of the size of the 10Y SGS re-opening.



Source: MAS, Bloomberg, OCBC Research

IDR:

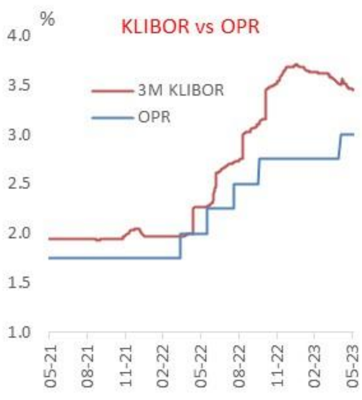
IndoGBs outperformed USTs substantially in May as the sell-off in USTs did not spill over onto the domestic bonds. MoF issued at below indicative amounts at the recent sukuk and conventional bond auctions despite strong incoming bids, as there was no funding pressure. According to Finance Minister, fiscal surplus stood at IDR234.7trn as of end April, as fiscal revenue reached 40.6% of budget while the MoF managed to spend only 25% of budget; net bond issuance amounted to IDR240trn, 35% of full year target. Bank Indonesia kept its policy repo rate unchanged as expected; the central bank said it would continue with operation twist by selling short-term bonds in the secondary market to increase the attractiveness of the domestic bonds. Indeed, IndoGB-UST yield differentials have been further compressed especially at the front-end; chasing the yields lower is not preferred, and foreign inflows may be concentrated at longer tenors. IndoGBs saw foreign inflows amounting to IDR6.67trn in May, with foreign holdings standing at IDR829trn of 15.26% of outstanding as of 31 May.



Source: Bloomberg, OCBC Research

MYR:

MGS have been resilient with yields higher by 10-12bps at the front-end and down by 4bps at the 10Y over the past month, outperforming USTs by a wide margin. We expect 3Y MGS to trade around current level in a range of 3.35-3.45% as the yield spread with OPR looks fair. We have an upward bias to 5Y and 10Y MGS yields on resilient economic growth and compressed yield spreads over USTs. 3M KLIBOR have been grinding lower, despite the latest OPR hike; the move is in line with our expectation for some normalization in the 3M KLIBOR-OPR spread while liquidity appears supportive. We have penciled in a level of 3.40% for 3M KLIBOR, but the move may be very slow given that the spread has already narrowed a lot.



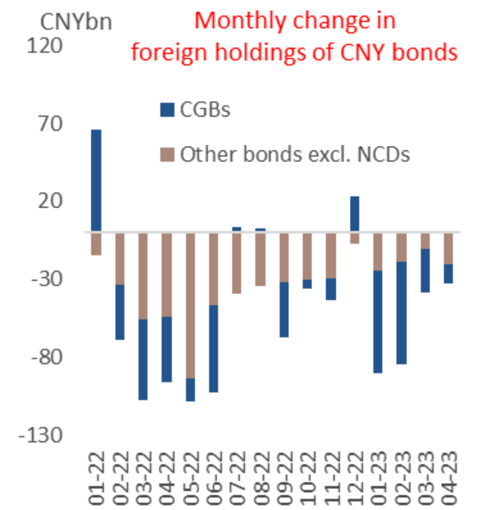
Source: Bloomberg, OCBC Research

CNY:

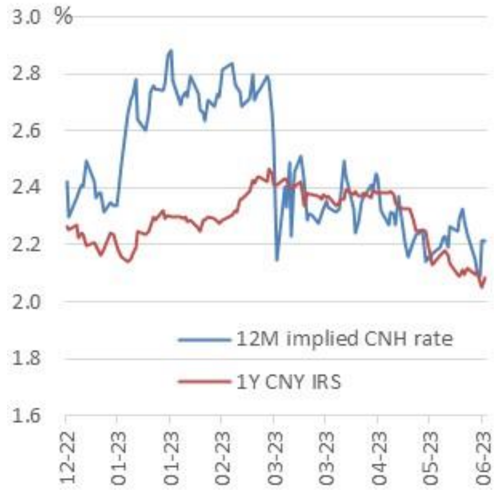
Repo-IRS have been on a downtrend since late April, as data mostly printed on the soft/weak side. The PBoC granted CNY125bn of MLF in May against maturity of CNY100bn, thereby net injecting CNY25bn of liquidity while expectation was for a full rollover only. The net liquidity injection was small if not negligible, but it sent a signal to the market that the PBoC stays supportive via quantitative tools. Although LPR and MLF rate have been kept unchanged, expectation is for an accommodative monetary policy. Our medium-term higher CNY rate view did not pan out as economic recovery has not come as strong; **we have turned neutral CNY rates near term**.

CNY rates softened when US rates and yields went up during the month, rendering interest rate/yield differential more unfavourable for the RMB which is not constructive for the flow picture on a few fronts. **A strong comeback of bond inflows is not on the horizon yet**; and if there is no improvement in CNY-USD rate differentials, that could also mean corporates may not fully roll over USD loans (but switch some to RMB loans) when these loans mature thus pointing to potential outflows. Onshore CNY bonds continued to see outflows, at CNY32.5bn (excluding NCDs) in April, similar to the outflows of CNY38.5bn in March; outflows from CGBs narrowed to CNY11.7bn but outflows from PFBs were bigger at CNY15.5bn after a virtually flat month in March.

On the FX swap curve, back-end CNY and CNH points have fallen on more negative CNY-USD rate differentials. Lowered CNY IRS mean lower floors to offshore rates as well: 1Y repo-IRS at around 2.05/2.10% versus 12M implied CNH rate at 2.20/2.25% and 1Y CNH CCS (against SOFR) at 2.10/2.15%.



Source: CEIC, OCBC Research



Source: Bloomberg, OCBC Research

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