OCBC TREASURY RESEARCH

Interest Rates Monthly

17 March 2023

March FOMC in Focus

- Our base-case remains for a 25bp hike at the March FOMC meeting. The FOMC cannot ignore the implications of rate levels on financial stability; this shall argue against reverting to a bigger hike. But the FOMC shall be keen to maintain its credibility by basing their policy decision mostly on the data – and the data still support some more tightening. The FOMC, however, may have to change their forward guidance, dropping the "higher for longer" narrative. Afterall, this "higher for longer" narrative does not entirely agree with decisions being "data dependent".

- Basis across markets had experienced some downward pressure amid the recent market jitters, as investors tended to increase precautionary preparation for dollar liquidity. The movements were nevertheless contained, and USD liquidity has stayed broadly supportive on an aggregate level, not least because the Fed's balance sheet is still huge. We have also highlighted the USD2trn fund that is parked at the Fed's o/n reverse repo facility can potentially serve as a liquidity buffer.

- The CNY rates and CGB market was pretty much insulated from the global bond market volatility. The PBoC has stayed supportive of liquidity in view of market demand. We maintain our upward bias to CNY rates on expected growth recovery and inflation pick-up. While the 5% growth target may be seen as conservative, growth remains a top priority; we do not see the CNY3.8trn special LGB quota as low; there has already been front-loading of issuances and if needed, there is room for additional issuances.

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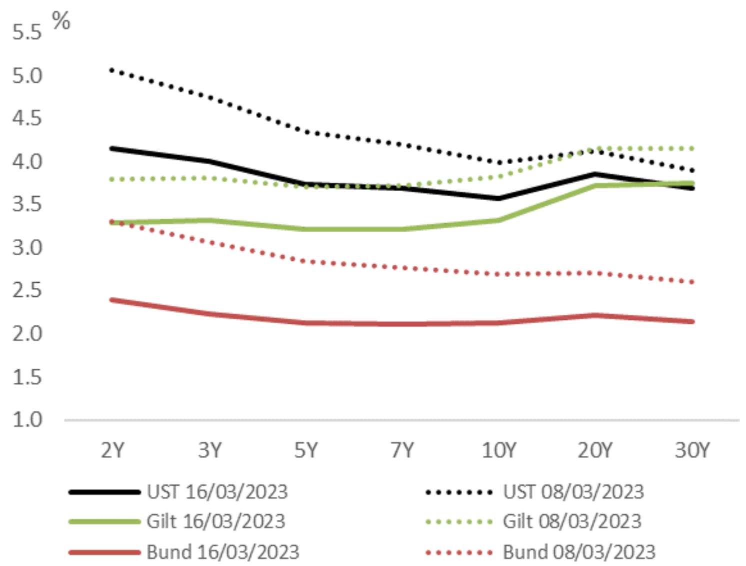
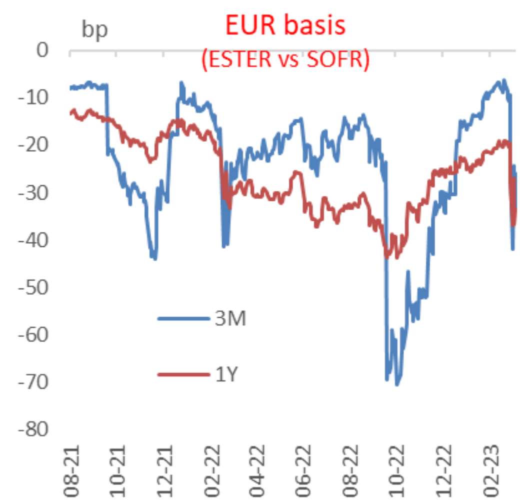


Source: Bloomberg, OCBC Research



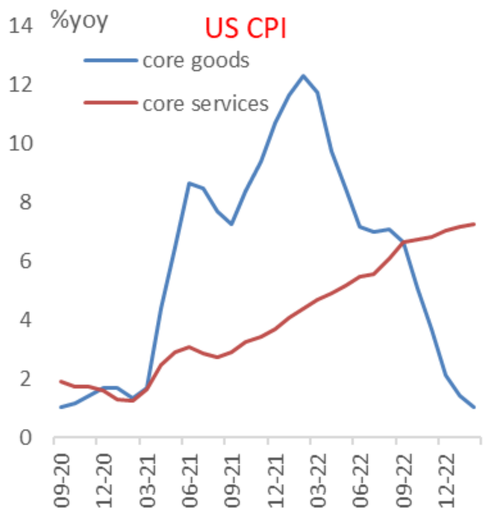
Source: Bloomberg, OCBC Research

USD:

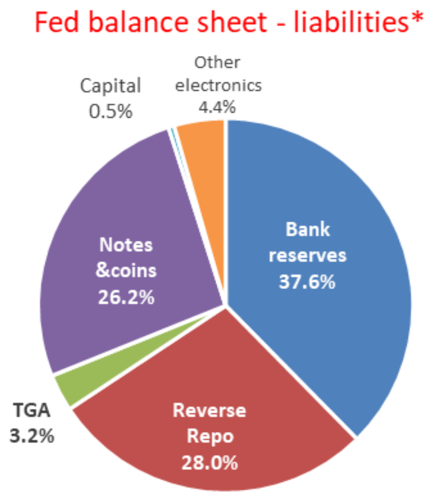
Our thoughts on the March FOMC. The latest development in the US banking sector is complicating the Fed's rate hike decisions, but we still believe a 25bp hike is the more likely outcome. The FOMC cannot ignore the implications of rate levels on financial stability; this shall argue against reverting to a bigger hike. However, the FOMC shall be keen to maintain its credibility by basing their policy decision mostly on the data; they may also want to avoid being seen as panicking, precisely at times when reassuring confidence is key. The FOMC, however, may have to change their forward guidance, dropping the "higher for longer" narrative. Afterall, this "higher for longer" narrative does not entirely agree with decisions being "data dependent". Also, the Committee have to take note of the implication of the various rates levels on the distribution of liquidity across assets/tenors. For example, there are USD2trn of funds parked at the Fed's o/n reverse repo facilities, which is paying 4.55%. We have expected higher yields on other market instruments will attract some funds away from this overnight facility over time. That said, in the scenario where market liquidity is impacted materially, different adjustment to administered rates compared to that to the Fed funds rate target range cannot be ruled out. That all being said, should market jitters continue, it would become a very tough decision between a pause and a small hike.

CPI. February CPI came in mostly in line with expectation, with a small upside surprise in core CPI. The divergence between core goods inflation and core services inflation deepened, as core goods inflation decelerated to a meagre 1.03% YoY, but core services inflation picked up further to 7.26% YoY. The uptick in core services inflation was primarily due to the rent of shelter component. There is a justification for the FOMC to stay vigilant against inflation risk, given the 58.2% weight for core services versus 21.3% weight for core goods in the CPI basket. One caveat is the very high base effect for June, which will drag down headline YoY inflation meaningfully. We will however be surprised if the FOMC had not taken this into account when they made all those hawkish comments over the past months.

USD liquidity. Basis across markets had experienced some downward pressure amid the recent market jitters, as investors tended to increase precautionary preparation for dollar liquidity. The movements were nevertheless contained, and USD liquidity has stayed broadly supportive on an aggregate level, not least because the Fed's balance sheet is still huge. We have highlighted the USD2trn fund that is parked at the Fed's o/n reverse repo facility can potentially serve as a liquidity buffer. Usage at USD2.056trn on 16 March was USD163bn lower than the recent high registered on 9 March.



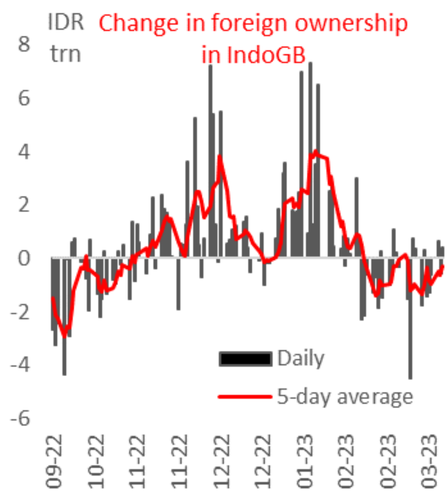
Source: CEIC, OCBC



Source: Bloomberg, OCBC
*as of 15 March

IDR:

IndoGBs underperformed USTs over the past week as the flight-to-quality trade has pretty much been more dominating in the USD market than in the IDR market. On the bright side, short-end yield differentials between IndoGBs and USTS have widened, becoming more favourable to foreign investors who had increased the proportion of allocations to longer-end bonds in their bond holdings over the past couple of months. Flow-wise in terms of the amounts, IndoGBs registered outflows of IDR7.69trn in the month to 15 March.



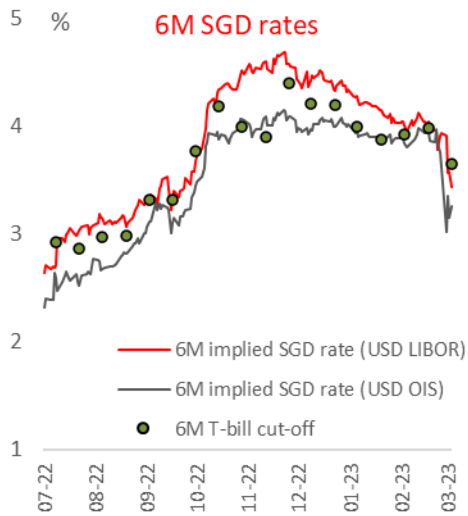
Source: Bloomberg, OCBC

Fiscal. Recent bond auctions awarded bonds around indicative amounts; the latest auction benefited from the global bond rally which saw cut-offs very near lower incoming bid levels. The MoF raised IDR190.6trn of funds as of 14 March, versus full year financing needs of IDR598.2trn. Moreover, a fiscal surplus of IDR131.8trn was registered in the first two months of the year. There is no pressure to upsize issuances at upcoming auctions.

Bank Indonesia kept its policy 7-day reverse repo rate unchanged at 5.75% as widely expected. We remain of the view that there is unlikely to be further rate hikes in this cycle. BI would continue with operation twist to sell bonds of short tenors and with the foreign currency term deposits (TD Valas DHE), which did not come as a surprise either. Demand for the FX deposit has thus far concentrated on the 1M tenor; the FX TD being relatively new and the highly volatile USD rates of late may be the reasons that exporters adopted a wait-and-see approach. We do however note some progress over the first few auctions, in that interest has extended from tier 1 to tier 2 and 3 reflecting a broader participant base.

SGD:

SGD rates underperformed USD rates in the downward move from the recent highs just before the revelation of the SVB fallout. First, as it appears to be more like a US-centric issue, flight-to-quality flows in the SGD market have not been as heavy as in the USD market. Second, investors have likely faded the MAS tightening trade alongside the dovish re-pricing of global central banks. The basis curve fell, which was not surprising as investors tended to increase precautionary preparation for dollar liquidity. Should market confidence stabilize and investors re-focus on fundamentals, an upward bias would return to SGD rates and the basis.

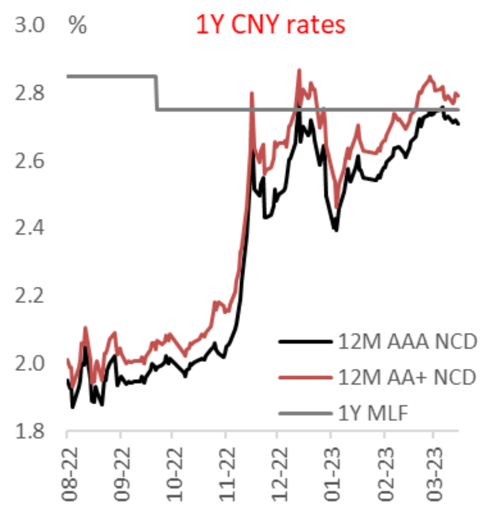


Source: Bloomberg, OCBC

The latest 6M T-bill cut off at 3.65%, lower than the 3.98% at the auction on 2 March. The 3.65% cut-off was already on the high side compared to implied SGD rates – the cut-off did not drop as much as would have been implied by the market. Although bid/cover ratio stayed decent at 2.77x, the result showed investors might be reluctant to chase the yield much lower.

CNY:

The CNY rates and CGB market was pretty much insulated from the global bond market volatility. PBoC did an outsized MLF at CNY481bn against maturing amount of CNY200bn, thereby net injecting CNY281bn. The liquidity support reflects that the PBoC recognizes the demand from the market, when NCD maturity is still heavy while LGB issuances are ongoing. Given that NCD rates have been hovering around MLF rate over the past couple of months (instead of being lower than MLF rate for most of 2022), MLF is a relevant funding facility at which demand is there. We **maintain our upward bias to CNY rates** on expected growth recovery and inflation pick-up. While the 5% growth target may be seen as conservative, growth remains a top priority and the growth target may be better seen as the lower bound of a range.



Source: Bloomberg, OCBC

Bond supply. 2023 deficit numbers point to net (central) CGB supply of CNY3.16trn (vs CNY2.66trn net issued in 2022) and net general LGB supply of CNY720bn (vs CNY718.2bn net issued in 2022). On top of these, the (new) special LGB quota has been planned at CNY3.8trn. We do not see CNY3.8trn as low; there has already been front-loading of issuances and if needed, we estimate there is room for additional issuances of around CNY600bn.

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