

Interest Rates Thoughts

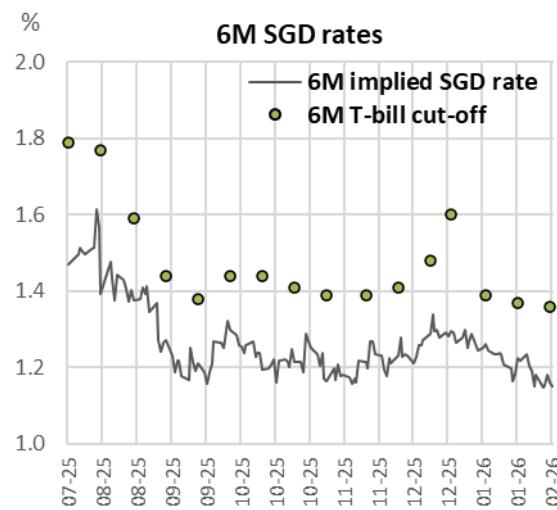
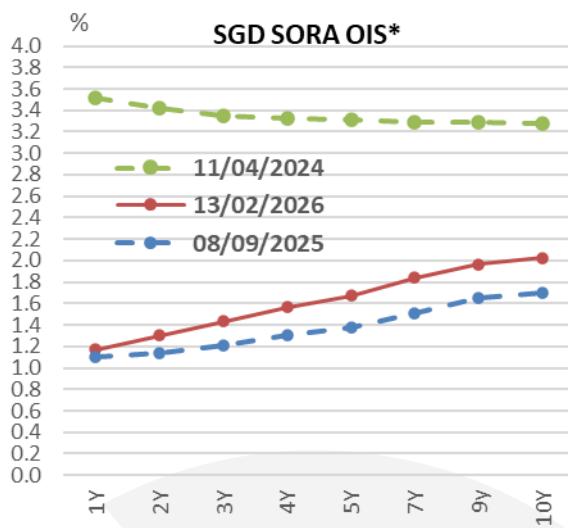
Safe-haven flows

- **USD rates.** USTs rallied by 5-7bps on Thursday with the curve mildly flatter benefiting from safe-haven flows, with the 10Y yield back to the trading range of 4.00-4.20%. The 30Y coupon bond auction was well received, garnering a bid/cover ratio of 2.66x versus 2.42x prior; indirect accepted was higher at 69.9% versus 66.8% prior. Cut-off came through at 4.750% despite the richening in the bond into the auction. USTs more than recouped the losses made upon payroll/labour market data releases. The overnight rally, however, again renders the bond market more sensitive to upside data surprises with CPI tonight. Beyond near term fluctuations, we maintain our multi-month target of 4.00% for 10Y UST yield, which will be consistent with 10Y breakeven at around 2.2% and real yield at around 1.8%. The bond supply outlook is neutral for the quarters ahead, while there is a small room for 10Y breakeven to edge lower.
- **Fed balance sheet policy.** We expect continuity in balance sheet policy. What happened to front end funding rates in late 2025 suggests that bank reserves below US2.9trn may no longer be ample. The Fed has ended QT, while RMPs (reserve management purchases) started from 12 December. These decisions represent a consensus view at the Fed. RMPs are likely to stay at around USD40bn per month before April, and to become smaller afterwards. Redemption from agency securities is estimated at around USD15bn per month. As per the most recent Quarterly Refunding Documents, TBAC (Treasury Borrowing Advisory Committee) estimate a total of USD540bn of T-bills demand (USD180bn from MBS paydowns and USD360bn of RMPs) by the SOMA portfolio in 2026. TBAC's estimate on RMPs appears to be on the high side. We see the potential for the Fed to reduce RMPs by more after April. Nevertheless, this would point to slower RMPs. We do not expect a reduction in the balance sheet anytime soon.
- **SGD rates.** SGD rates have fallen by 15-25bps YTD, as we had earlier flagged the risk of interim retracement lower. SGD assets are likely to continue to benefit from safe-haven flows, and S\$NEER has stayed near the top side of the band. SGD liquidity may stay supportive, if not flush, for now. Meanwhile, OCBC economists have recently upgraded Singapore 2026 GDP forecast to 3%, while maintaining inflation forecast at 1.3%. Against the macro backdrop, interest rates at or below 1.5% appears stimulative, and rates at or below 2.0% are still likely supportive of economic activities. There are two-way risks surrounding interest rates. Nevertheless, corporates may consider partially locking in funding costs as rates

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are likely low compared to potential project returns given the economic outlook. The SGD OIS curve no longer exhibits a U shape. At current levels, the 3-5Y segment appears to be the new sweet spot. At the shorter end, the negative carry may last for a considerable period compared to the tenor itself.

On cash side, Thursday's 6M T-bills cut off at 1.36%, reflecting a wider spread over the 6M implied SGD interest rate compared to the last auction on 29 January. Bid/cover was still solid at 2.02x, but the wider spread suggests that investors may demand a slightly bigger premium when the absolute level of interest rate is low. The 2Y bond/swap (OIS – yield) spread has also become less positive. Further out the curve, however, demand appears to come in for portfolio diversification with investors putting a lower weight to the pick-up. Next supply is the reopening of 2Y SGS on 25 February, with the size to be announced on 19 February.

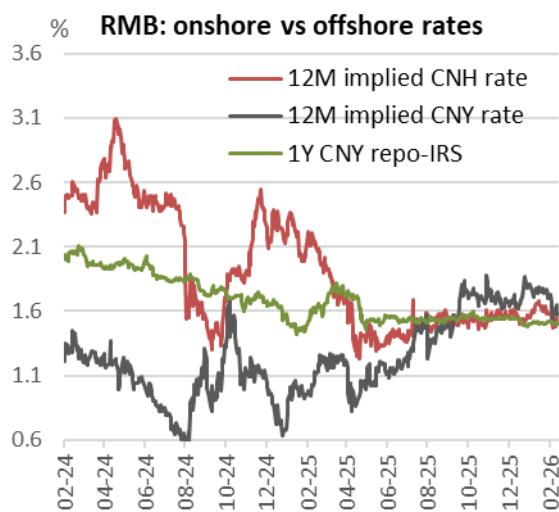


Source: MAS, Bloomberg, OCBC Group Research

*dates are chosen to mark the two-year high and low of 2Y SGD OIS.

- **CNY rates.** PBoC conducted CNY1trn of 6M outright reverse repos today, outsize the CNY500bn of outright reverse repos with original 6M tenor that mature in the month. PBoC recently did four rounds of 14-day reverse repos in daily OMOs, which is the usual practice ahead of the long holidays. 1Y and 2Y repo-IRS traded soft, hovering around the 1.5% level which we have seen as an interim floor before the next policy rate cut. In CNH, cut-offs at Wednesday's auctions of offshore CGBs were near onshore levels reflecting strong demand. With the offshore and onshore yield curves not far apart, the offshore curve is likely to move more in tandem with onshore, while offshore yields may also be floored by onshore levels. On rates side, offshore implied CNH rates are lower than onshore implied CNY rates, reflecting flush CNH liquidity.

Southbound Stock Connect flows have been solid, with net-buy amounting to HKD64bn month-to-date as of 12 February, compared to HKD69bn in the whole of January, adding to the CNH liquidity pool. Still, the offshore pool remains limited. We do not expect the phenomenon of offshore rates being lower than onshore rates to be sustained.



Source: Bloomberg, OCBC Group Research

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