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Interest Rates Thoughts

USD and SGD rates views

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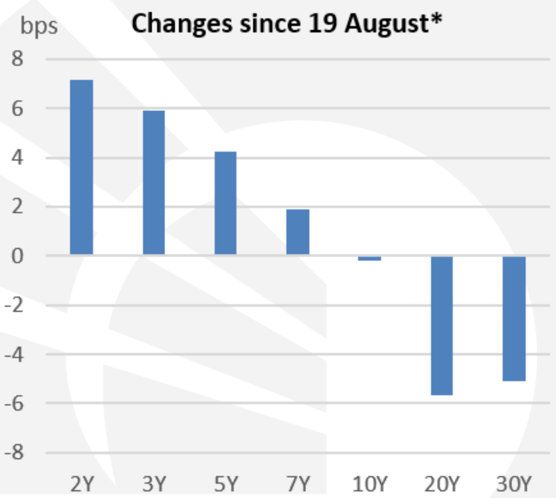
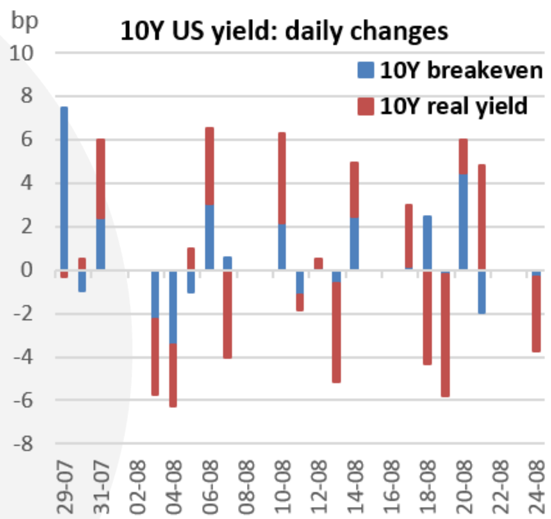
- **USD rates.** Compared to levels on 18 August – the day before the announcement of more buybacks of long-end bonds, short-end UST yields are around 6-7bps higher, 10Y yield is little changed and 20Y and 30Y yields are around 5bps lower, i.e. the curve mildly flattened. While breakeven has been creeping up recently, real yield has remained as the bigger driver for the increases in long end US yields which reflect resilient US growth, and (via the term premium) lingering fiscal concerns, and competition from corporate issuances and selected DM government bonds. 10Y term premium was last at 0.8159% on 20 August as estimated by NY Fed's ACM model. As the 10Y term premium has widened from the low levels seen in late June (at below 0.5%), further upside to the 10Y nominal yield from this component may have become more limited. We maintain our near-term expected range for 10Y UST yield at 4.60-4.75%.

- Fiscal concerns may continue to dominate longer-end performances, with investors staying cautious against the 20Y and 30Y tenors. That said, we also note the possibility of reduction in long-end supply, as there is both willingness and leeway to do so. On balance, range for 30Y UST yield is seen at 5.15-5.30%. Next key event is Jackson Hole. While Warsh has shown reluctance to provide forward guidance, Jackson Hole is a platform for him to provide some elaboration on the Fed's reaction function. Before that, July PCE/core PCE are to be released.



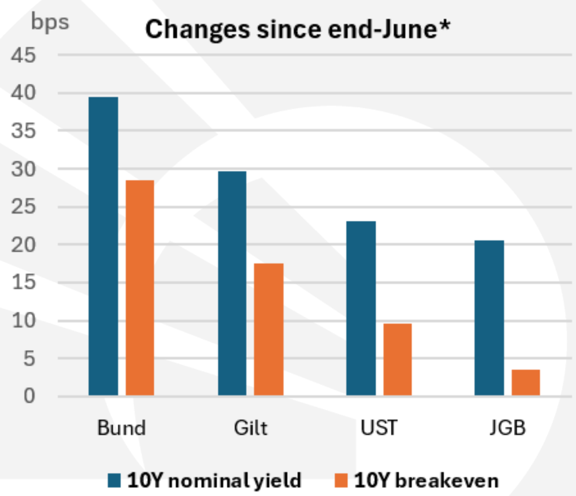


Source: Bloomberg, OCBC Group Research
*as of 25 August Asia morning

- **UST Supply**. Doubling the buybacks at the 10-20Y and 20-30Y buckets amount to USD14bn, while Bessent has said the buybacks can be more. The amount is still likely small compared to supply or outstanding. Nevertheless, there is the possibility that US Treasury may consider reducing the supply of long-end bonds if demand stays weak. First, there is willingness to do so, as reflected by the tweak in the guidance in the recent quarterly refunding documents – to "potential future changes" from "potential future increases" in auction sizes. Second, there is leeway – weighted average maturity of marketable debt outstanding was last at 70 months, versus multi-year average of 61.4 months.

- We wrote last week that to fund the additional buybacks, US Treasury can reduce buybacks of shorter tenors, or to tap their TGA balance. TGA balance was last at USD933bn on 21 August, but US Treasury has reduced the target to USD850bn for end-December. If they are to tap the cash, the balance needs to fall below 850bn, given current revenue and outlays estimates. There is still some room to do so, but the buffer is not as thick as when the target was at USD950bn.

- **Long-end yields**. The latest leg of upward move in government bond yields started from late June/early July. While it would be convenient to characterise the performances as synchronized moves, we note the difference in terms of the drivers for the increases in long-end yields. Compared to end-June levels, the increase in 10Y breakeven explained 72% of the uptick in 10Y bund yield and 59% of the uptick in 10Y gilt yield; the corresponding percentages were lower at 42% for 10Y UST yield and 17% for 10Y JGB yield. Inflation is seen as more sensitive to global factors in Europe, while resilient US growth (which contributes to higher real yield) and Japan being in reflationary phase are other factors.

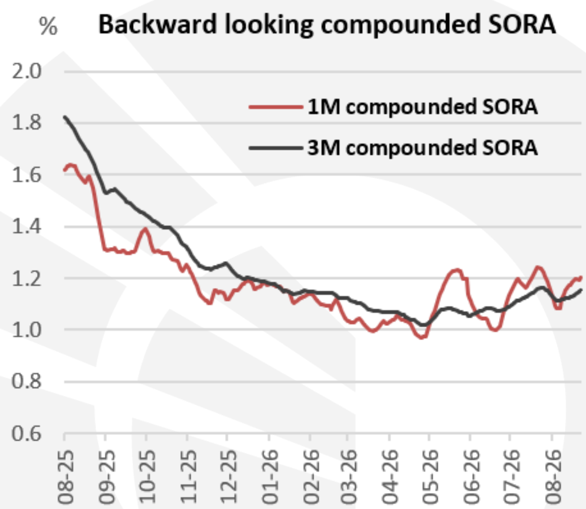


Source: Bloomberg, OCBC Group Research, as of 24 August.

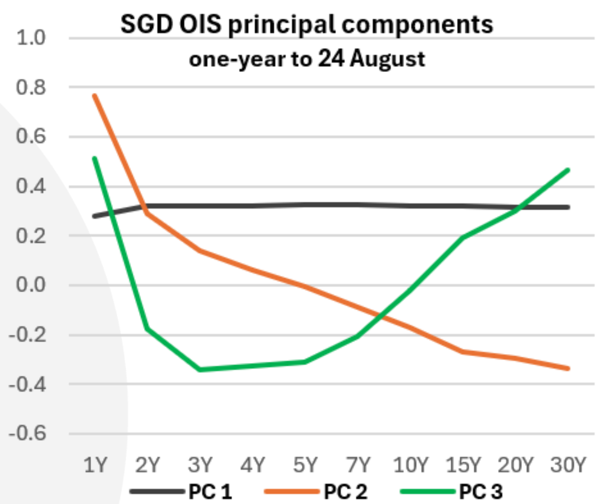
- **SGD rates**. SORA fixing was last at 1.3605% on 24 August, after touching a high of 1.4968% on 18 August. SORA fixing averaged 1.27% thus far this month, higher than July's average of 1.16%, which is in line with our upward bias to SORA in a non-linear move. Compounded SORA, due to their backward-looking nature, lag SORA in a trend move. Compounded SORA grinding higher with the 1M rate higher than 3M rate at times reflects such trend move. SGD OIS have underperformed USD OIS month-to-date, with USD-SGD OIS spreads having narrowed by 2-9bps, more so at the 1Y and 2Y tenors as short-end rates played catch-up.

- Our forecasts have assumed an upward normalization in SGD rates, and some normalization in SGD-USD rates spreads as well. For the SGD OIS curve, our PCA using one-year data suggests some flattening pressure exerted by a positive shock from the second principal component, as opposed to a steepening pressure if longer time series (two-year and five-year) are used. OIS levels are unsurprisingly mainly explained by the first principal component (95%), which is mostly parallel with a smaller impact on the 1Y rate. On balance, the next targets for 1Y and 2Y SGD OIS are 1.55% and 1.75%, respectively. Again, the expected upward move is unlikely to be linear.

- On the SGD OIS curve, 1Y and 2Y tenors continue to be seen as sweet spots for hedging/locking in funding costs. Further out, the 2s5s segment has narrowed mildly compared to early August/late July levels, while 5Y SGD OIS at 2.0-2.1% level is not particularly high compared to the economic backdrop and outlook. As such, partial hedging via the 5Y rate can also be considered.



Source: Bloomberg, OCBC Group Research



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