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Interest Rates Thoughts

UST curve steepened on Fed hold

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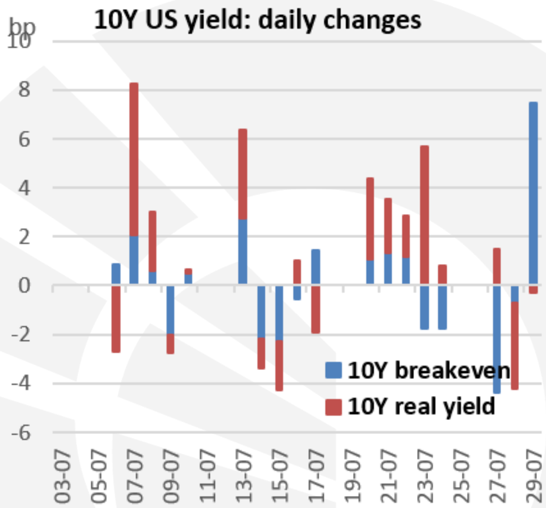
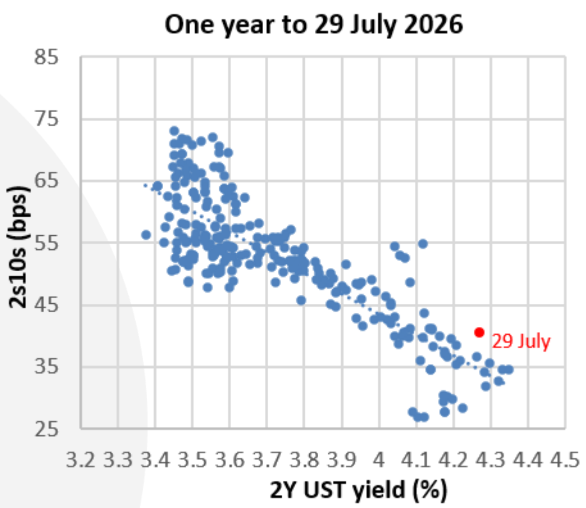
- **USD rates**. The UST curve steepened upon the status quo decision by the FOMC. The presence of three dissenters was not more hawkish than market expectation. 2Y yield fell by 12bps from intra-day high at one point, ending the day 6bps lower than intra-day high or 1.5bp lower than previous close. Market pared back rate hike expectation, to a 66% chance of a 25bp September hike versus fully pricing it in before FOMC decision; Fed funds futures last priced a total of 35bps of hikes by year end versus 42bps priced prior. Our base-case remains for the FOMC to keep the target range for the Fed funds rate unchanged at 3.50-3.75% for the rest of the year. We have flagged the risk of a hike, which if materialises, would likely be reversed in 2027. Market is likely to hold onto expectation for some tightening, given the fluid geopolitics development and hence the uncertain inflation outlook. Range for 2Y UST yield may remain at 4.25-4.35% for now. Immediate focus is June PCE/core PCE tonight. For market to further pare back rate hike expectations, another round (July) of benign inflation prints together with some de-escalation in geopolitics are likely required. On a multi-month horizon, we expect market to gradually reduce hawkish pricing, premised on our expectation for some easing in oil prices; if this view materialises, then the 2Y UST yield has room to edge back towards the 4.00-4.05% area by 4Q26 or 1Q27.

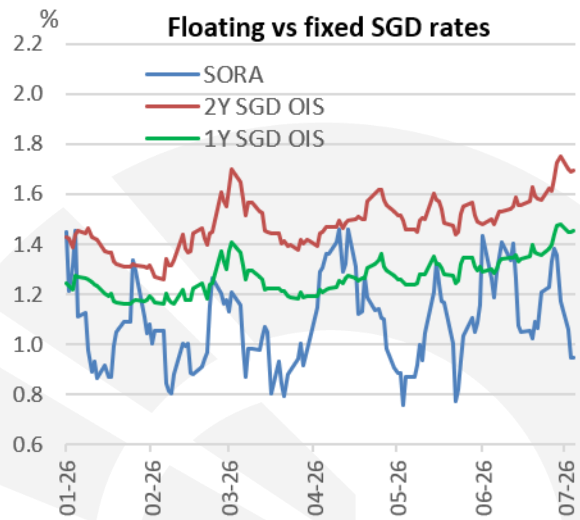


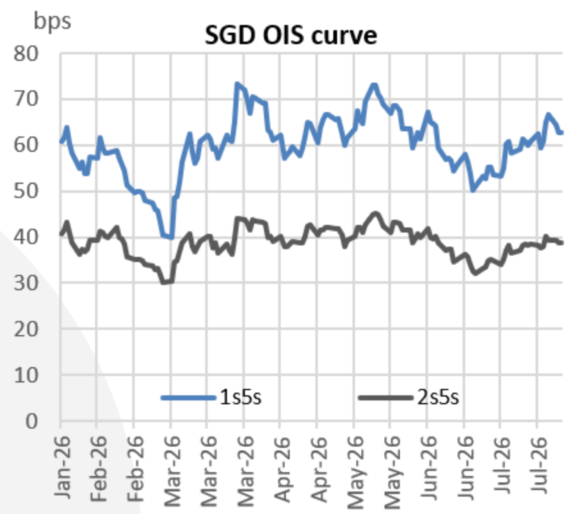


Source: Bloomberg, OCBC Group Research

- At the longer end, breakevens rose overnight, explaining most of the increases in nominal yields, as we have warned of upside risk to US breakevens partly as a catch-up to some other DMs and to oil price itself. 10Y real yield edged lower, which was also in line with our bias. As the 2s10s segment has steepened in recent days, from below 1-year trend line to above, as and when short-end UST yields ease, there is also room for the 10Y UST yield to follow. In the near term, range for 10Y UST yield is seen at 4.55-4.75%.

- **SGD rates**. We have had an upward normalization view for SGD rates. After the recent increases in USD rates and the recent SGD rates underperformance, SGD OIS are now trading near our year-end forecasts for most tenors except the very front end. SORA the overnight rate continues to fluctuate over the days; although fixings were relatively high (above 1.20%) on some of the days, it has remained mostly below OIS. We continue to expect SORA to move to a higher range, fluctuating around the 1.4% level by year end. The negative carry at pay positions may however slow the upward momentum in SGD OIS, and some interim retracement in SGD OIS cannot be ruled out – which is better seen as opportunities for locking in funding costs at better levels. We remain of the view that upside room is bigger than downside room in SGD rates. On the SGD OIS curve, 1Y and 2Y tenors are sweet spots for hedging, with the 1s5s and 2s5s segments having re-steepened. On bond side, SGS may garner some support at current levels, as bond/swap spreads (OIS – SGS yield) have turned negative for most tenors after a period of SGS underperformance against swaps.





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