Interest Rates Thoughts

Yields rose on geopolitics

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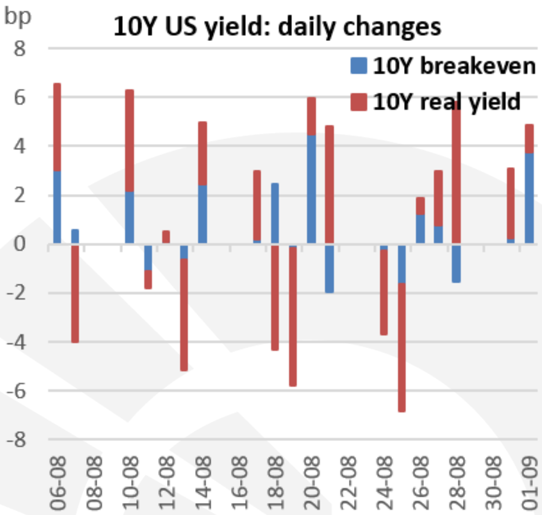
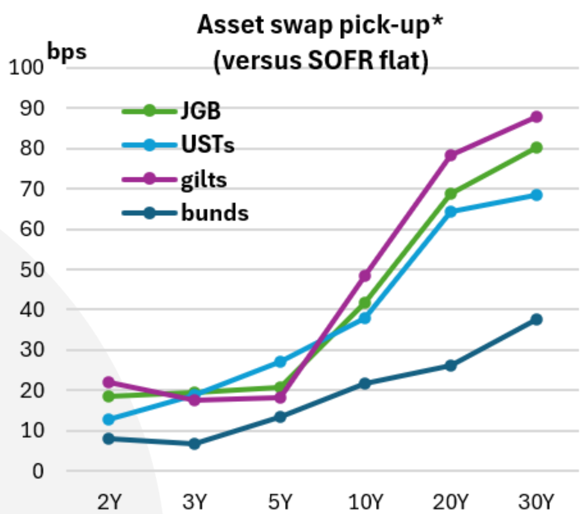
- **USD rates.** US yields rose overnight on heightened geopolitical tensions as US and Iran exchanged fresh attacks. Earlier in the NY session, yields once fell upon the JOLTS data releases. July JOLTS job openings printed lower than expected while June's figure was revised downward. Data were apparently overwhelmed by geopolitical developments. Our base-case for the FOMC to keep Fed funds rate unchanged this year is partly based on contained inflation pass-through thus far, but we acknowledge the risk for a hike being delivered has risen given recent hawkish comments from Warsh and the prospects of renewed inflation pressure. Still, market pricing of a total of 64bps of hikes by mid-2027 is on the hawkish side. We therefore have a downward bias to 2Y UST yield although this view may take time to materialise. In the near term, investors may also prefer shorter duration given the re-escalation in geopolitics. Earlier during Asia and Europe sessions, JGB and gilt yields already rose, and there may still be some follow-through. Long-end JGBs and gilts are potential competitors to USTs for investor demand given comparable yield pick-up.

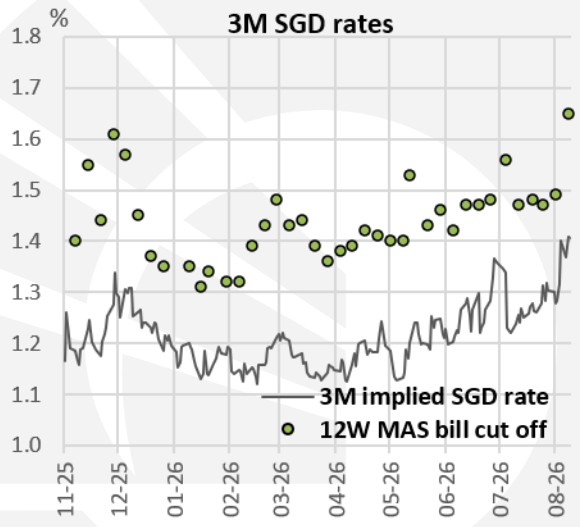


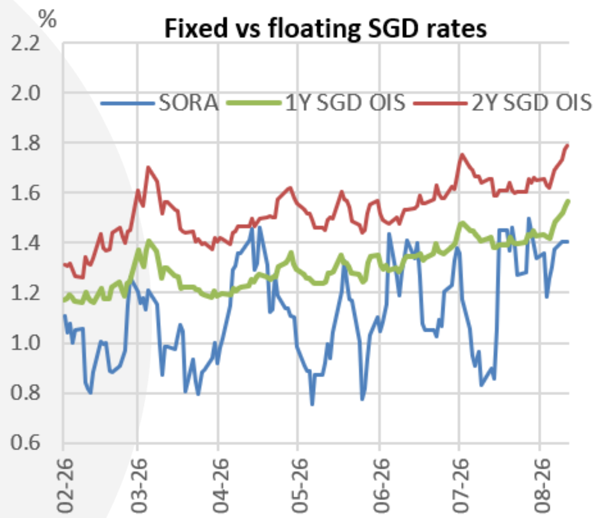


Source: Bloomberg, OCBC Group Research
*1 September 2026

- **JPY rates**. We are bringing forward our expected 25bp BoJ policy rate hike to the September meeting from the October meeting previously anticipated. July CPI and August Tokyo CPI YoY readings accelerated as expected. While monetary policy does not target exchange rate, a weak yen does have an impact on prices. BoJ opined the pass-through from exchange rate to prices seems to be getting stronger. Key question is whether the BoJ will deliver a third hike within this year, thereby quickening the pace of tightening compared to the twice-a-year pace. Policy normalization is likely to continue given a tight labour market, pro-active firms' price-setting behaviour, and imported inflation pressure. BoJ raises rates to normalise monetary policy, as the policy rate has stayed negative in real term. We expect a total of 50bps of hikes in 2027, and there is room for more hikes.

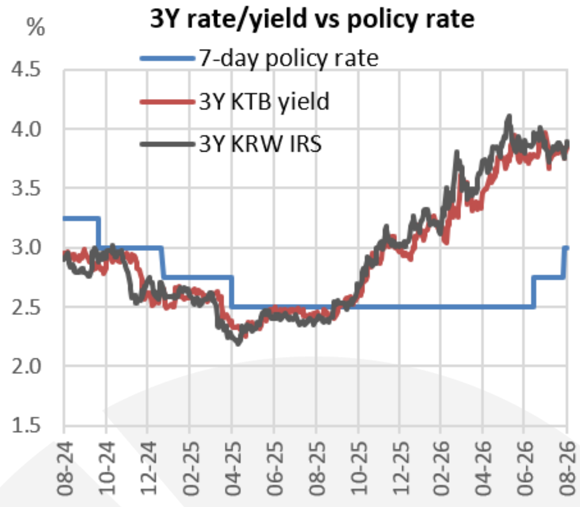
- **SGD rates**. Our forecasts have assumed an upward normalization in SGD rates, and some normalization in SGD-USD rates spreads as well. This view has mostly panned out. SORA was fixed above 1.30% on 11 of the 21 days in August, touching a high of 1.4968% on 18 August. SORA averaged 1.28% in August versus 1.16% in July. This is in line with our upward bias to SORA in a non-linear move. 1Y and 2Y SGD OIS has already breached our near-term targets of 1.55% and 1.75%. Before SORA move up at a more rapid pace, further upward move in SGD OIS may be more gradual than that observed during July and August. Tuesday's MAS bills cut-off came in higher at 1.53%, 1.65% and 1.65% at the 4W, 12W and 36W tenors, respectively, alongside the higher implied SGD rates. We note the spread between 12W cut-off and 3M implied rate widened to the high end of our assumption of 20-25bps. On bond side, year-to-date SGS issuances amounted to SGD25.5bn. Assuming the October mini auction does not go ahead and modest sizes of the remaining two scheduled auctions of the year, growth in outstanding SGS this year is still likely to outpace that of last year. We therefore expect modest auction sizes ahead. Light supply is likely to lend some support to SGS, potentially leading to SGS outperformance against swaps.

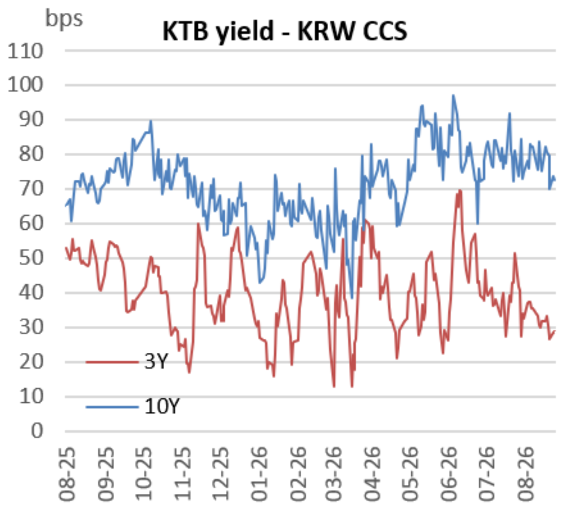




Source: MAS, Bloomberg, OCBC Group Research

- **KRW rates**. KTB yields opened a few bps higher this morning, taking cue from the global markets. Last week, KTB reaction to the 25bp BoK policy rate hike was muted. First, the 25bp hike had been expected. Second, the outcome was seen as dovish. Governor Shin said "delayed action could require larger policy response" implying the pre-emptive move might result in a less aggressive hiking cycle. The "median dot" under the updated projection points to one additional 25bp hike on the 6-month horizon. OCBC economists expect the central bank to keep policy rate on hold at 3.00% for the remainder of the year, before another 25bp hike in 1Q-2027 representing "a moderate pace of hikes" after the back-to-back hikes. The spread between 3Y KTB yield and policy rate narrowed to around 90bps, from more than 110bps in mid-August. The spread is wide enough compared to our base-case for the policy rate to peak at 3.25%. Further upside to 3Y KTB yield is likely to be limited. However, asset swap pick-up at 3Y KTB has narrowed over the past weeks, last at around SOFR+29bps. On balance, range for 3Y KTB yield is seen at 3.75-3.95%.





Source: Bloomberg, OCBC Group Research

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