

Daily Market Outlook

1 July 2024

Relative Calm

- **USD rates.** UST yields fell upon the May PCE print which came in soft, but the reaction did not last. Bonds got sold off towards the end of the session as investors were probably sceptical about how the Fed would react to a single month's data given all the rhetoric about patience and rebounds in inflation elsewhere including in Canada and Australia. Fed funds future pricing was little changed, while long-end USTs underperformed on the curve and as such it was not entirely because of the data and monetary policy outlook. There was also net coupon bond settlement as we had mentioned last week, at USD49bn on Friday and another USD95bn tonight. Market quickly looked past PCE and forward to this week's labour market report. With 10y real yield at 2.1% and breakeven at 2.3%, there does not seem to be much downside to the 10Y nominal yield in the coming days, but upside appears even less likely. Expect 10Y UST yield to range between 4.25% and 4.40% near-term. At the front end, SOFR edged up to 5.34% which was nothing more than half year-end effect. Liquidity has stayed largely supportive; usage at the Fed's o/n reverse repo increased further to USD664bn on Friday amid bills paydown in past weeks. For this week, there is net bill settlement of USD10bn, and we expect some stabilization in reverse repo usage.
- **DXY. ISM Manufacturing Today.** The start of the new quarter met with relative calm in FX markets as USD traded on the back foot. USDCNY daily fix was steady (7.1265 vs. 7.1268 last Fri) while French first round outcome was more or less in line with what opinion polls were previously suggesting – a 3-way split with no major surprises. Focus will eventually shift to second round elections (7 Jul) after filing papers for candidates closes on Tue 6pm. Risks for EUR remain 2-way. Focus is on whether Marine Le Pen's far right party gets an absolute majority in the National Assembly, to allow it to pass legislation more easily. Potentially this scenario can be more negative for EUR than a hung parliament outcome. For the week, focus is also on ISM data (Mon) and payrolls (Fri). Softer print should help to see USD ease. That said, the recent US Presidential debate (28 Jun) served as a reminder how election risks in US can be fluid and polling now indicate Trump leads Biden. Trump's better showing over Biden may further add to USD premium. DXY was last at 105.62. Bullish momentum on daily chart intact but shows signs of fading while

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RSI fell. Support at 105.20 (21, 50 DMAs), 104.80 (61.8% fibo retracement of Oct high to 2024 low). Resistance at 106.20.

- **EURUSD. Short Squeeze.** Outcome of the first round of French legislative election saw no major surprises. Initial projections from polling companies suggest that far right Rassemblement National (RN) party was projected to get 33% and 34.2% of the vote, left wing coalition to get between 28.5% and 29.6% of the vote and Macron's centrist alliance to get between 21.5% and 22.4% of the vote. In more than half of the 577 constituencies, 3 people qualified for the second round runoffs. And typically some candidates may drop out to prevent a vote split so as to give their ally greater chance to stop the far right from advancing. Bloomberg reported that *Jean-Luc Melançon of the New Popular Front, an alliance of left-wing parties, said that he would encourage third-placed candidates from his group to withdraw, while Macron himself released a statement calling for "a broad, clearly democratic and republican alliance for the second round."* Some voters may choose to adopt tactical voting (i.e. vote not to support but vote to keep the other party out or "le vote utile"). Eyes will be on Tuesday 6pm (France time), when deadline filing papers for candidates closes and we will get some clarity on the run-offs. Potentially, EUR may face renewed pressures. Markets are on the look-out on whether Marine Le Pen's far right party gets an absolute majority in the National Assembly, to allow it to pass legislation more easily. Potentially this scenario can be more negative for EUR than a hung parliament outcome. 10y OATS-Bund spread remained wide at +79bps. The concern is still on potential fiscal direction far-right parties may be taking and if the 'cohabitation' outcome comes into play (when the President and PM are from opposing parties). EUR was last at 1.0750 levels. Bearish momentum on daily chart shows signs of fading while RSI rose. Risks skewed to the upside. Resistance at 1.0760 (21 DMA), 1.0780 (50 DMA), 1.0810 (38.2% fibo retracement of 2024 high to low, 100 DMA). Support at 1.0710, 1.0660/ 70 levels (recent low).
- **JPY rates.** Q2 Tankan survey came in strong, especially at large enterprises and non-manufacturers. Fixed investment plan was revised up across large, medium-sized and small enterprises. Inflation outlook was revised mildly higher; for output prices, 1-year inflation outlook at 2.8% (previous 2.7%) and 3-year inflation outlook at 4.1% (previous 4.0%). Expectation for general prices has also stayed firmly above 2.0%. These set a more conducive backdrop for BoJ to go ahead with monetary policy tightening in terms of both policy rate and its balance sheet. We expect the BoJ target rate to be raised to 0.2-0.3% by year end, while passive QT is also likely to be underway starting some time in Q3. To achieve "a sizeable reduction in the purchase amount" of JGBs, the BoJ may tweak its monthly purchase guidance of JPY6trn to JPY4.0-5.0trn. 10Y JGB yield was up by 3bps this morning; we continue to see the next support for the 10Y JGB at 1.15-1.25% in terms of yield.

- USDJPY. Markets Still Eyeing Intervention.** USDJPY continued to trade near recent highs. This is also near the highest level since 1986. There are expectations that Japanese authorities could soon intervene. While the level of JPY is one factor to consider, officials also focus on the pace of depreciation as the intent of intervention is to curb excessive volatility. Falling and relatively lower realised vols vs previous intervention periods suggest that officials may continue to adopt wait-and-see approach, alongside verbal jawboning instead of direct market intervention. That said, if realised vols start to pick up or USDJPY sees a rapid move towards 164-165 (from current spot), then actual intervention can potentially materialise. In the interim, USDJPY will look to UST yields, USD for directional cues. For USDJPY to turn lower, that would require the USD to turn/Fed to cut or for BoJ to signal an intent to normalise urgently (rate hike or increase pace of balance sheet reduction). None of the above appears to be taking place. As such, the path of least resistance for USDJPY may still be to the upside, for now. Pair was last at 160.90. Bullish momentum on daily chart intact while RSI in in overbought conditions. Next resistance at 161.20 (138.2% fibo projection of 2023 low to 2023), 164 levels. Support at 157.70 (21 DMA), 156.60 (50 DMA).
- USDSGD. Watching US Data for USD Cues.** USDSGD slipped as sentiments stabilised. EUR rallied after French election outcome came in within expectations. While RMB and JPY were near recent weak levels, they did not weaken further. Pair was last at 1.3550 levels. Mild bullish momentum on daily chart intact but RSI fell. Another pullback not ruled out. Support at 1.3520/30levels (50 DMA, 61.8% fibo retracement of Oct high to Jan low), 1.35 (100 DMA) and 1.3460 (50% fibo). Resistance at 1.3590, 1.3620 (76.4% fibo). Our estimates show S\$NEER has been easing. Last at 1.7% above model-implied midpoint.
- CNY rates.** June non-manufacturing PMI came in weaker than expected at 50.5 points, while manufacturing PMI stayed below the 50-threshold at 49.5 points. Nevertheless, CGBs traded on the soft side this morning, with the 30Y yield up by 1bp. We have opined that *a bullish bond market may be counterproductive in that policy makers could be reluctant to ease monetary policy just yet given their concerns about investors taking on too much duration risk*. PBoC net withdrew CNY48bn of liquidity via reverse repos this morning, which is in line with the usual pattern after quarter end passed. There are CNY700bn of reverse repos maturing for the rest of the week and partial rollover is likely. OMO reverse repo rate (and decade back, OMO repo rate) has been effectively serving as a policy rate. PBoC injects liquidity via reverse repos and as such the OMO reverse repo rate acts as the cap of an interest rate corridor. If OMO repos were to be conducted, then OMO repo rate could serve as the floor as this would be the rate the PBoC pays to absorb excess liquidity from the market. Being conducted regularly, daily OMOs can be

effective in guiding market interest rates within a range. In offshore, CNH deposits at banks in Hong Kong rose further to CNH1.134trn as at end-May, mainly reflecting corporates' fund flows. With persistent Southbound Stock Connect flows, offshore CNH deposits are likely to continue to edge up.



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