Daily Market Outlook

29 July 2024

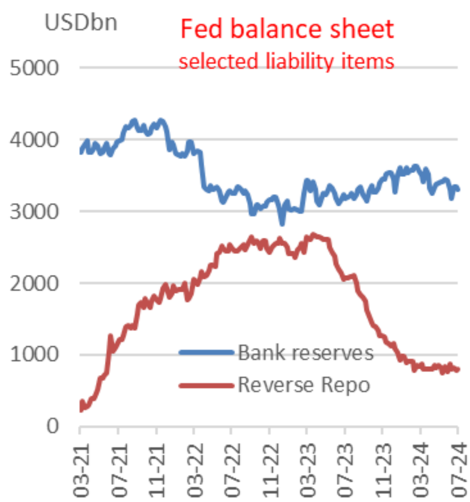
Focus on BoJ, FOMC, BoE

Frances Cheung, CFA
FX and Rates Strategy
FrancesCheung@ocbc.com

Christopher Wong
FX and Rates Strategy
ChristopherWong@ocbc.com

Global Markets Research and Strategy

- **USD rates**. UST rallied on Friday as June PCE printed mostly in line and market held onto rate cuts expectations. Fed funds futures last priced a total of 69bps of cut by year end, with a 25bp cut more than fully priced by the September FOMC meeting. Expectation for this week is a status quo, which is also our base-case. Investors may look for any dovish signal from the FOMC statement and/or Powell's Q&A, but we doubt if the Committee will be willing to signal it is prepared for a rate cut at a future (September) meeting. Regardless, unless Powell strongly pushes back on the prospect of easing, market is likely to stick with the expectation for a September Fed funds rate cut. US Treasury is to release quarterly refunding documents tonight, followed by auction sizes on 31 July. We expect the wider fiscal deficits to be funded by additional bill issuances while nominal coupon bond auctions are unlikely to be upsized. On the week, there is net coupon bond settlement of USD76.4bn and net bills settlement of USD41bn. With bank reserves standing at USD3.3trn and reverse repo at USD806bn as of 24 July, the Fed is likely to allow QT to run through to year end, before making the next decision.



- **GBP rates**. An August cut by the BoE has been our long-held view, though it has become a close call recently. GBP OIS priced the chance at 58%, while there appears to be split opinions within the BoE MPC. Earlier in the month, June CPI came in a tad firmer than expected, in particular with services inflation sticky downward. Nevertheless, month-on-month CPI inflation eased to 0.1% versus 0.3% prior, while RPI and PPI output inflation eased. The main drag to YoY inflation in June was again the category of housing, water, electricity, gas and other fuels, due to the energy price cap. Our base-case is for YoY CPI inflation to hover around the already low 2% level, premised on low energy prices, which should be good enough for the BoE to deliver two 25bp cuts by year-end. The Labour government have promised to bring in "a genuine living wage that accounts for the cost of living" and lower the eligible age to 18 from 21, referring to the National Living Wage, *aka* minimum wage. We have highlighted upside risk arising from wage growth and hence resilient consumers, which may reduce the room for rate cuts in 2025. QT is currently running at an annual pace of GBP100bn for the period October 2023 to September 2024, when GBP50bn of Gilts held under APF matured/mature. For the next 12-month period, APF gilt maturity is at GBP87bn. Even if BoE maintains this annual GBP100bn pace, heavier APF gilt maturity will be a buffer to active gilt sales. There is even a possibility that the BoE may decide to slow QT to be passive only, without active gilt sales.

- **JPY rates**. JGB yields edged lower this morning taking cue from the global market. The directional bias remains an upward one for JPY rates and yields. The macro backdrop is constructive for BoJ to go ahead with further monetary policy tightening in terms of both the policy rate and its balance sheet. Our base-case is a 10bp hike in the BoJ target rate at the July MPC, which is not fully priced by the market. We do not rule out a hike of a different – bigger - magnitude. Meanwhile, to achieve "a sizeable reduction in the purchase amount" of JGBs, we expect the BoJ to tweak its monthly purchase guidance of JPY6trn to around JPY4trn, with risk that this guidance will be reduced by more. There are some JPY15-19trn of JGBs held by the BoJ maturing in each quarter. A monthly purchase pace of JPY4trn would translate into passive QT of around JPY22trn on a one-year horizon counting from this quarter, which still represents a slow pace of balance sheet run-off given the balance sheet size of JPY760trn. The BoJ will probably feel comfortable to start with such pace. We continue to see the next support for the 10Y JGB at 1.15-1.25% in terms of yield.

- **DXY. *Busy Week.*** DXY started the week on a softer footing as risk sentiments held up for Asian equities. Focus this week on JOLTS report (Tue), ADP employment (Wed), FOMC (Thu 2am SGT), ISM mfg (Thu) and payrolls report (Fri). Markets will keep a look out on whether the tightness in labour markets continue to ease and on FOMC, what the guidance may be. Markets expect the Fed to lay the groundwork for a Sep cut especially with data coming in softer and Fed's rhetoric turning less hawkish. USD bears would face disappointment if Fed restraints dovish guidance. That said, the bigger driver for USD would be on payrolls report and the next few inflation readings – to get a sense of the possible extent of rate cuts. Another surprise for the USD would be an unexpected Fed cut at the upcoming FOMC. DXY was last at 104.15. Bearish momentum on daily chart faded but RSI shows signs of turning lower. Bearish crossover observed earlier as 21 DMA cuts 50, 100 DMAs to the downside. Support at 103.98 (50% fibo), 103.65 (recent low) and 103.20 (38.2% fibo). Resistance at 104.80/90 (61.8% fibo retracement of Oct high to 2024 low, 21, 50, 100 DMAs), 105.40 levels.

- **USDJPY. *Near Term Oversold but Bias to Sell Rallies.*** Recent decline in USDJPY shows tentative signs of taking a pause but the decline has also seen a recoupling of USDJPY back to UST-JGB yield differentials. During the period of May - Jul, USDJPY has gone one way higher while UST-JGB yield differentials narrowed – a de-coupling of its traditionally positive correlation – which was unusual. The recent sharp decline in USDJPY has somewhat reset that anomaly. And if we do expect USDJPY to play catchup to the

historical correlation with UST-JGB yield differentials, then USDJPY may still have room to trade lower. This would require Fed-BoJ monetary policy bias to converge further and faster (i.e. Fed to cut and BoJ to tighten more). We reckon this would happen at some stage but may proceed slowly (for now) instead. Hence, more patience is required for USDJPY to head lower. Ahead of BoJ and FoMC event risks this Wed and Thu, respectively, USDJPY may continue to trade choppy. Markets are expecting BoJ hike and a taper of its bond purchase program. The combination of BoJ policy normalisation and Fed possibly cutting rate in due course is a case of monetary policy convergence and should underpin USDJPY downside. The risk is that BoJ fails to live up to expectations and USDJPY risks a sharp correction upwards. USDJPY was last seen at 153.35. Bearish momentum on daily chart intact while RSI fell into near oversold conditions. Cautious of rebound risks for USDJPY from oversold conditions but at the same time, JPY shorts remain at record and uncertainty may see continued unwinding of stretched short position in JPY. Bias to fade rallies. Resistance at 155.50 (100 DMA), 156.80 (76.4% fibo). Support at 153.66 (61.8% fibo retracement of 2024 low to high), 151.60 (200DMA) and 151.10 (50% fibo).

- **USDSGD. *Consolidation*.** USDSGD was a touch softer, tracking the modest slippage in USD and somewhat supported sentiments this morning. Pair was last seen at 1.3415 levels. Daily momentum is flat but RSI fell. Consolidation likely. Support here at 1.3410, 1.3390 (38.2% fibo retracement of Oct high to Jan low). Resistance at 1.3460 (200 DMA, 50% fibo), 1.35 (50, 100 DMAs). S$NEER was estimated at ~1.86% above our model-implied mid, largely steady from the past few sessions.

OCBC

GLOBAL MARKETS RESEARCH

Macro Research

Selena Ling
Head of Research & Strategy
lingssselena@ocbc.com

Tommy Xie Dongming
Head of Asia Macro Research
xied@ocbc.com

Keung Ching (Cindy)
Hong Kong & Macau Economist
cindyckeung@ocbc.com

Herbert Wong
Hong Kong & Taiwan Economist
herberthtwong@ocbc.com

Lavanya Venkateswaran
Senior ASEAN Economist
lavanyavenkateswaran@ocbc.com

Ahmad A Enver
ASEAN Economist
ahmad.enver@ocbc.com

Jonathan Ng
ASEAN Economist
jonathanng4@ocbc.com

Ong Shu Yi
ESG Analyst
shuyiong1@ocbc.com

FX/Rates Strategy

Frances Cheung, CFA
Head of FX & Rates Strategy
francescheung@ocbc.com

Christopher Wong
FX Strategist
christopherwong@ocbc.com

Credit Research

Andrew Wong
Head of Credit Research
wongvkam@ocbc.com

Ezien Hoo
Credit Research Analyst
ezienhoo@ocbc.com

Wong Hong Wei
Credit Research Analyst
wonghongwei@ocbc.com

Chin Meng Tee
Credit Research Analyst
mengteechin@ocbc.com