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Interest Rates Thoughts

Bond rally lacks momentum; BoK hike on the cards

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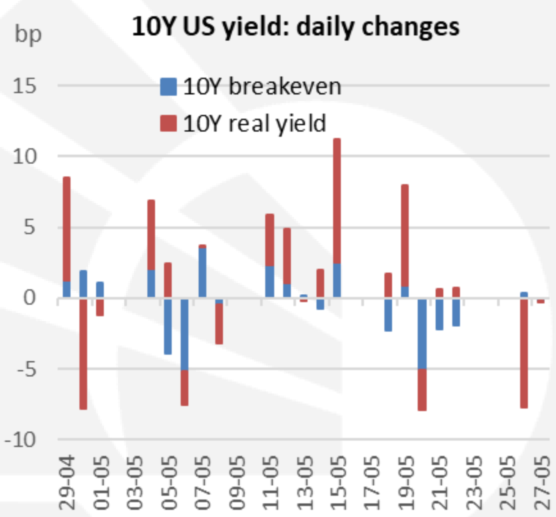
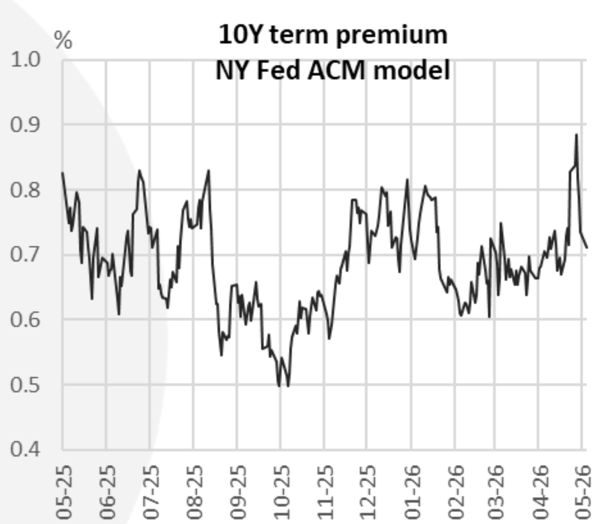
- **USD rates**. There appears to be a lack of momentum for Tuesday's bond rally to be extended, with yields trading in tight ranges on Wednesday and a tad higher this morning as US denied an Iranian media report that there was an interim peace deal. Market stays responsive to geopolitics development. 10Y UST yield last hovered around the 4.50%. As we wrote recently, "a break below 4.50% would require further easing in inflation expectations and some narrowing in the term premium, the prospect of which hinges on the uncertain development in geopolitics". Term premium has not widened too much and as such downward move in real yield as a whole would be required. On the data front, tonight brings the release of April PCE/core PCE and durable goods orders, among others. Near-term range 10Y UST yield is seen at 4.45-4.55%.

- Fed comments continued to mostly come in on the hawkish side, cautioning against inflation risks: Kashkari said inflation remains his top priority; Cook said she was prepared to raise rates if the expected disinflation does not appear in a timely manner. Meanwhile, Cook described the labour market as largely stable but said downside risks to employment are elevated. This precisely shows the dilemma the Committee face with their dual mandate, while the stance of "prepared to raise rates" – which is shared by some other Fed officials as well – may be better seen from a risk management perspective, in our view.

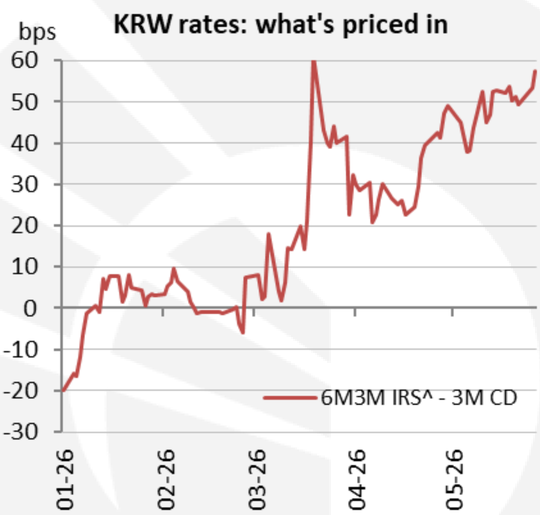


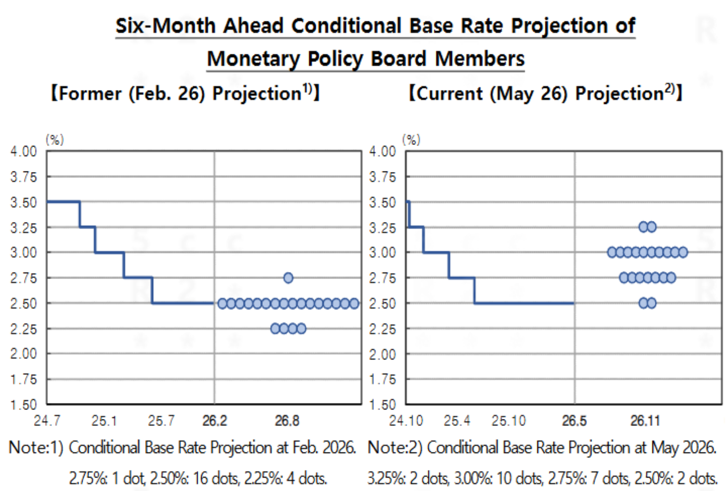


Source: Bloomberg, OCBC Group Research

- **KRW rates**. KRW IRS were paid up by 5-7bps in response to BoK policy rate decision. BoK kept policy rate unchanged at 2.50% as expected, but the decision was not unanimous with two dissenters calling for a 25bp rate hike. The median dot on BoK's "dot-plot" points to two hikes (10 dots out of 21 dots) on a 6-month horizon, although a significant minority (7 out of 21 dots) expects one hike. The statement removed the mentioning of "downside risks to growth" and replaced it with "economic growth is expected to continue its solid improvement trend … despite the impact of developments in the Middle East", paving the way for a policy rate hike as soon as at the July meeting. Governor Shin at the press conference sounded hawkish as well, quoted at saying "rate hike would have been justified at this meeting" and "CPI is likely to peak in 2H if policy responds well". The KRW IRS market has been pricing in around two hikes on a 6-month horizon; but given today's two dissenting votes and the explicit guidance, market reacted further to the hawkish side. We have one 25bp hike in Q3 on our forecast profile. Given resilient, if not solid, economic growth, risk is for additional rate hikes to follow. BoK revised up 2026 GDP forecast to 2.6% from 2.0% as previously expected; 2026 inflation forecast has been revised higher to 2.7% from 2.4% prior.

- **KTBs** cheapened by 5-8bps this morning. There is potential for KTBs to stabilise somewhat from here. First, 3Y KTB yield last traded at more than 125bps above policy rate, suggesting rate hikes are already in the price. Second, asset swap pick-up is still decent, last at around SOFR+41bps at 3Y KTB, and around SOFR+82bps at 10Y KTBs. Third, bond index inclusion is expected to bring in cumulative passive inflows of USD50-60bn when full weight is attained by November 2026.





Source: Bank of Korea, Bloomberg, OCBC Group Research ^implied

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