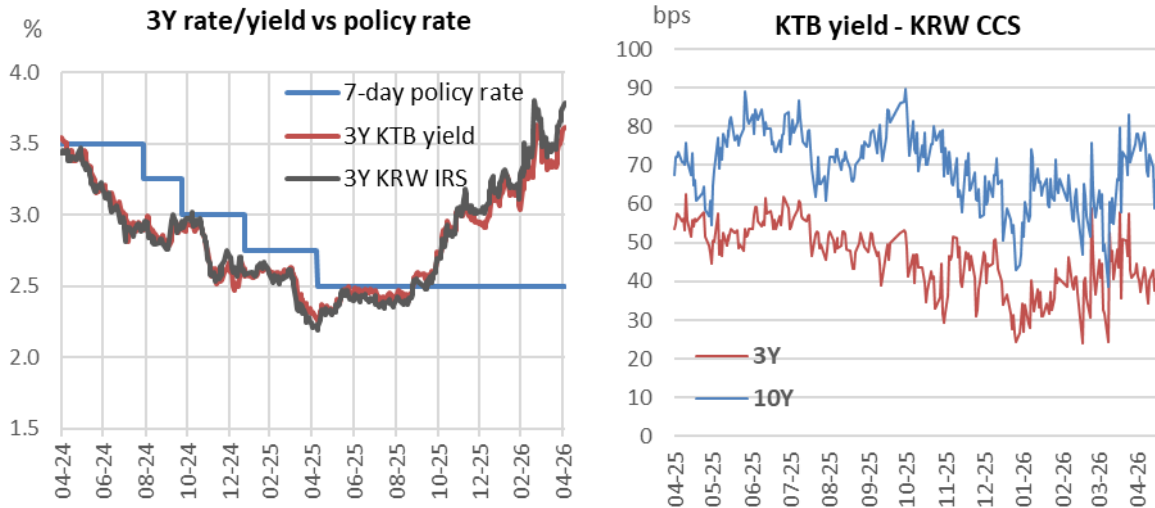


Interest Rates Thoughts

Hawkish BoK; RBA review

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- **BoK outlook.** KRW IRS were paid up by 2-3 at open this morning, before easing back to be little changed as of writing, as market returns from holidays. The KRW rate market has turned more hawkish upon strong data prints. April CPI accelerated to 2.6%YoY versus 2.2% in March, in line with expectations. April exports growth printed 48.0%YoY, following an upwardly revised 49.2%YoY in March, amid robust semiconductor demand. BoK expect CPI to rise further in May. Earlier, senior deputy governor Ryoo was quoted as saying it is time to consider a rate hike, citing the strong Q1 GDP growth. BoK still appears more likely to keep policy rate on hold at 2.50% at May meeting, the first meeting to be chaired by Governor Shin, but the central bank may send a more hawkish signal paving the way for a rate hike down the road. We now expect a 25bp hike in the base rate in 3Q2026 in view of the resilient, if not strong, economy and upside inflation risks. Market is pricing in roughly two 25bp hikes on a 6-month horizon.
- **KRW rates.** Over the past couple of weeks, KRW IRS have been paid up by more than 20bps cumulatively for most tenors, while KTBs were sold off underperforming USTs. The spread between 3Y KTB yield and 7-day policy rate widened to 110bps. During the rate hiking cycle in 2021/2022, this spread traded in a wide range of 50bps to 200bps, but mostly in a 50bps to 150bps range. In comparison, the current 110bp spread leaves an appropriate buffer for rate hike expectation at this juncture. Near-term range for 3Y KTB yield is seen at 3.55-3.70%.
- Potential passive flows on bond index inclusion may provide some support to the domestic bonds. Bond index inclusion is expected to bring in cumulative passive inflows of USD50-60bn when full weight is attained by November 2026. Full weight is expected at 1.89% in WGBI, at 2.07% in WGBI ex Japan, and at 2.34% in WGBI ex Japan ex China. The momentum appears to have started on a positive note, with inflows observed in April. WGBI weight is highest for bonds with tenors beyond 10Y, which provides some buffer to fiscal spending; while comparing to outstanding, KTBs at 3-7Y tenors may receive relatively more support. Asset swap wise, pick-up at 3Y KTB was last at around SOFR+38bps, and pick-up at 10Y KTB was last at around SOFR+59bps.

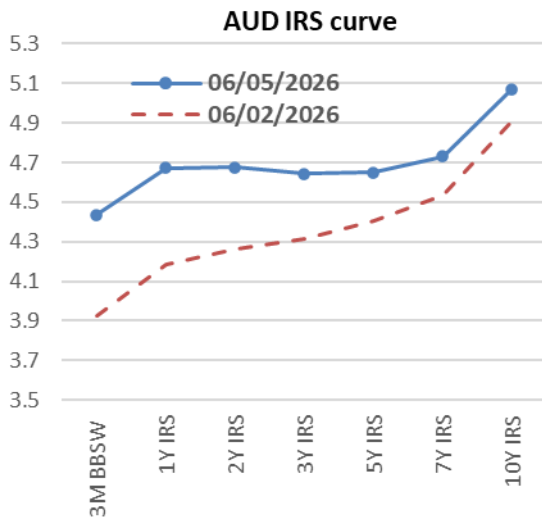


Source: Bloomberg, OCBC Group Research

- AUD rates.** Bank bills futures initially traded lower (implied rate higher) in response to RBA policy rate decision on Tuesday, before reversing the price actions for most contracts. ACGB yields fell, probably taking hint from a potential pause after three RBA rate hikes. We have opined that after this expected hike, with cash rate matching the peak of the last hiking cycle, there is more room for the RBA to become a bit more patient. We are not adding another rate hike to our forecast profile for now (i.e. we expect the cash rate to stay at 4.35%), noting there may be a pause in policy action. With market pricing remaining hawkish at 34bps of hikes before year end, we see upside room to AUD IRS as limited.
- RBA decision.** RBA decided to raise policy cash rate by 25bps to 4.35% at its May meeting, as widely expected. The vote was 8-1, with one member voting to keep cash rate unchanged. This vote split represents a hawkish tilt from March’s 5-4 split, especially considering a hike was delivered at the March meeting. The “outlook” para in the May statement is similar to that in the March statement: “monetary policy is well placed to respond to developments and the Board is focused on its mandate to deliver price stability and full employment. It will do what it considers necessary to achieve that outcome”. We however note two differences in the statement which may potentially hinting on a pause in hike, when the central bank assesses the impact of tightening thus far:

 - 1/ The May statement added “Having raised the cash rate three times” before the above guidance on the policy outlook. This suggests that the central bank has switched to a wait-and-see mode after previous tightening.

2/ The May statement commented “financial conditions have tightened this year” versus “Financial conditions have tightened a little this year, but the extent to which monetary policy is restrictive is uncertain” in the March statement. The removal of the second phrase suggests that the central bank has a higher conviction that rate is in a restrictive region.



Source: Bloomberg, OCBC Group Research

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