

Interest Rates Monthly

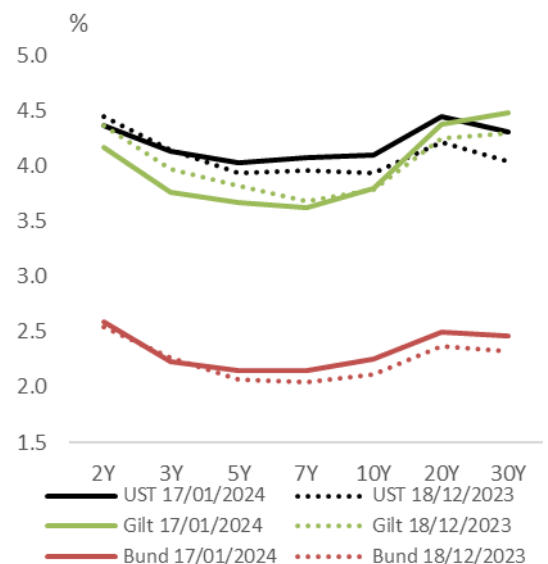
18 January 2024

Pushback on rate cuts expectations

- DM rates.** There had been some pushbacks from central bank officials against market expectations for aggressive rate cuts – more on the timing of the start of the easing cycle. Selected data in the US and UK also came in a tad firmer than consensus. While our base-case is for the Fed’s easing cycle to start in Q2 with 100bps of cuts pencilled in, market pricings of anywhere between 100bps and 150bps do not look unrealistic. GBP OIS pricing, after the latest adjustment, is not far from our base-case of 75bps of BoE rate cuts this year, which looks roughly fair. Among major DMs, the EUR OIS market may be more prone to hawkish adjustments. Meanwhile, there has been a renewed discussion among market participants regarding the timeline for slowing or ending QT in the US, which mainly hinges on the liquidity situation.
- IndoGBs** underperformed USTs over the past month, resulting in wider yield differentials. Bond flows have yet to make a strong comeback. While SRBI rates have edged lower over recent auctions, they were still relatively high compared to short-end bond yields. Before there are signals from BI that the domestic easing cycle is forthcoming, chasing short-end bond yields lower is not preferred.
- SGD rates** underperformed USD rates in the broad downward moves starting from October, in line with our view. We continue to expect SGD rates to lag on a downward move. On supply, focus in Q1 is the reopening of the 20Y bond, which is on the regular calendar versus being an optional mini auction last year. There may be a mild steepening pressure on the 10s20s part of the SGS curve nearer the time as investors position for the 20Y supply.
- CNY rates.** Despite easing prospects, we maintain our medium-term upward bias to CNY rates and CGB yields on supply risk and as market shall ultimately respond to the better growth outlook resulting from various support measures. We have had a more sanguine outlook for China bond flows since the October bond flow outcome; we expect further widening (as in becoming less negative) in CGB-UST yield differentials.

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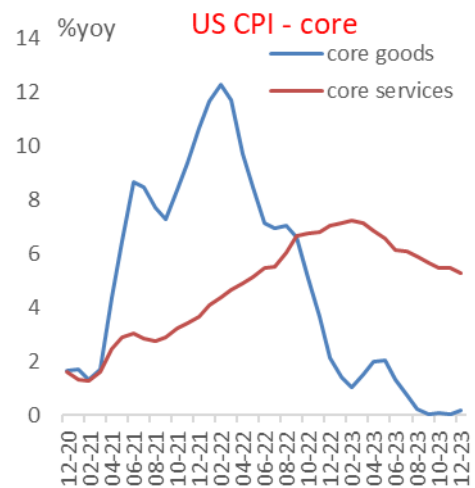
Source: Bloomberg, OCBC Research

USD:

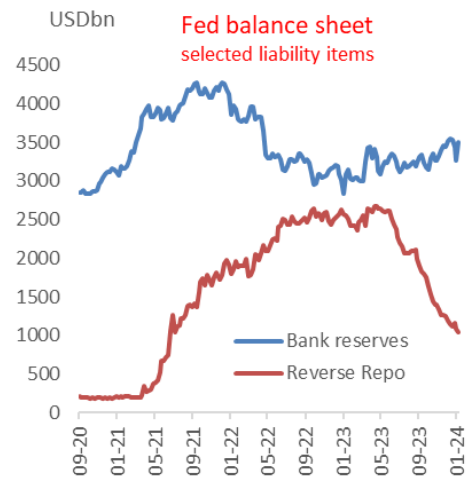
There have been continued pushbacks against imminent Fed rate cuts, from the December FOMC minutes, and then a slew of FOMC official comments. Data – including payroll, CPI and retail sales – also printed firmer than consensus. However, market reaction to the December US CPI prints illustrates that investors prefer to see data through a dovish lens. Despite some dovish adjustments of late, Fed funds futures still price more-than-an-even chance of a 25bp cut by the March FOMC meeting (albeit lower at 61% versus 83% priced earlier in the month), against our base-case for the easing cycle to start in Q2. But do not get us wrong. While we have pencilled in a total of 100bps of cuts this year, market pricings of anywhere between 100bps and 150bps do not look unrealistic. We expect some consolidation in yields in the weeks ahead, and potentially some upticks in yields as market stays sensitive to data prints while net bond supply is on the high side in the second half of February. On a multi-month horizon, we maintain a downward trajectory in rates and yields forecasts.

CPI Headline YoY inflation picked up to 3.4%YoY against consensus of 3.2%, while core inflation edged lower to 3.9%YoY versus expectation of 3.8%. Core services inflation printed 5.3% versus 5.5% prior, but core goods inflation edged marginally higher. It has been our view that *further disinflation hinges on easing core services inflation when core goods inflation was already minimal*. Sequential headline inflation picked up to 0.3%MoM from 0.1%MoM, illustrating that disinflation cannot be automatically extrapolated. The Fed’s prefer gauge of (dis)inflation momentum – core services excluding rent of shelter – did not ease. The uncertain inflation outlook shall reduce the chance of a Fed rate cut within this quarter.

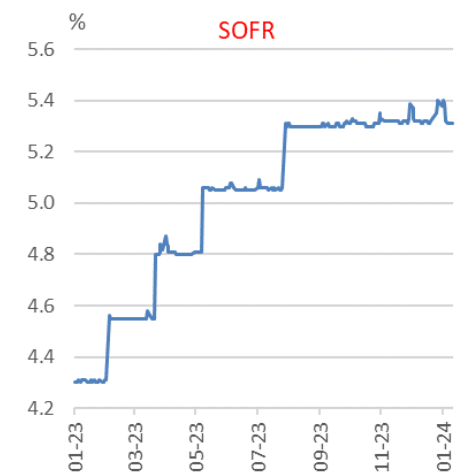
There has been a renewed discussion among market participants regarding the timeline for slowing or ending QT, since the December FOMC minutes revealed that several participants “suggested that it would be appropriate for the Committee to begin to discuss the technical factors that would guide a decision to slow the pace of runoff well before such a decision was reached”. **For how long QT can continue mainly hinges on the liquidity situation**, unless there is an urgent need to ease aggressively, for example should growth deteriorate rapidly. Bank reserves rebounded to USD3.50trn as of 10 January, after a dip to USD3.26trn on 3 January. Reverse repos continued to fall, more rapidly of late which was another trigger for the QT discussion; reverse repos stood at USD1.04trn as of 10 January while o/n reverse repos stood at USD590bn on 17 January. On aggregate, we still see a liquidity buffer of around USD1trn which shall allow the current pace of QT to continue throughout most of 2024. But there are a few considerations. First, estimates of the LCLOR vary and banks may want to keep



Source: CEIC, OCBC Research



Source: Bloomberg, OCBC Research



Source: Bloomberg, OCBC Research

reserves above LCLOR. Second, there is uncertainty as to how much more liquidity will be shifted from reverse repos, which depends partly on how T-bill yields move vis-à-vis RRP / Fed funds rate. Third, as Logan opined, “individual banks can approach scarcity before the system as a whole”. She cited the jumps in SOFR around end-November and end-December as reflecting that liquidity is no longer super abundant and it is not always in excess supply for everyone. The liquidity situation shall be monitored closely to gauge the potential timeline of QT.

EUR:

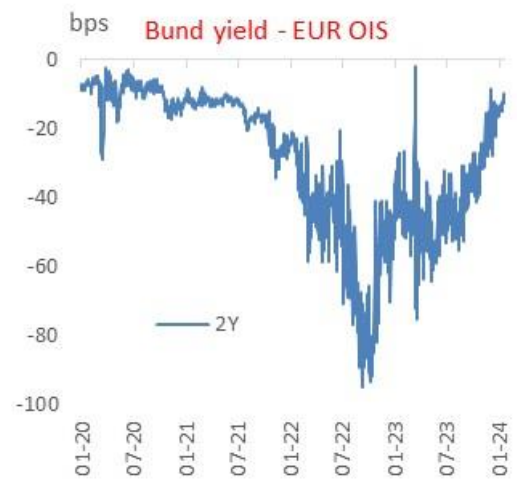
ECB officials tried to push back on expectation for an early start of the easing cycle, while last month we noted a few hawkish elements from the December MPC meeting. Holzmann, well-known as a hawk, opined that “we should not bank on the rate cut at all for 2024”. While this piece of opinion may be at the hawkish end of the dove-hawk spectrum to which market is unlikely to pay full attention, Lagarde and Lane’s earlier comments were not dovish either, saying it is much too early to talk about rate cuts and Nagel agreed that rate cut discussion is “premature”.

Notwithstanding ECB rhetoric, market still price in aggressive rate cuts as the rapid deceleration in inflation has added to market conviction. EUR OIS price in around 140bps of rate cuts for this year, with the chance of a 25bp cut by the April meeting price at 80%. The ECB may want to see Q1 wage and other labour market data before making any decision on the policy rates; these data will be out in May. As such, **pricing of an April rate cut looks overly dovish** to us and may be subject to some hawkish adjustment with upside risk to inflation potentially coming from wage pressure and/or geopolitics. We see limited room for short-end Bunds to further underperform EUR OIS.

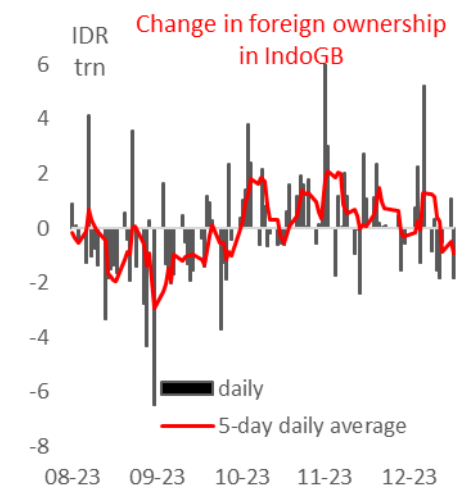
IDR:

IndoGBs underperformed USTs over the past month, resulting in wider yield differentials. Bond flows have yet to make a strong comeback, which continued to fluctuate, with YTD (as of 17 January) inflows amounting to a small IDR1.85trn, after the inflows of IDR8.2trn in December. Towards year end last year foreign investors were seen adding to duration – with 68.7% of holdings being longer than 5Y in December versus 59.8% in November.

Bank Indonesia kept its key policy rate unchanged as widely expected. There was however a lack of signal that the domestic easing cycle is forthcoming, as Bank Indonesia wants to see firmer gains in the Rupiah and will be “patient” in assessing the prospects for easing monetary policy. Meanwhile, although SRBI rates have edged lower over recent auctions, these rates are still high compared to short-end IndoGB yields. BI revealed foreign holding of SRBI was at IDR75.44trn. At end-December, foreign holding of SRBI had already increased to IDR62.17trn, or



Source: Bloomberg, OCBC Research



Source: Bloomberg, OCBC Research

24.4% of total outstanding, reflecting the attractiveness of the instruments. **Chasing short-end bond yields lower is not preferred at this juncture.**

Q1 issuance target has been announced at IDR240trn, which would be consistent with individual auction sizes of around IDR24trn for conventional bond and IDR12trn for sukuk. Demand at auctions thus far this year was overall decent. The conventional bond auction on 16 January garnered strong incoming bids of IDR67.56trn and MoF awarded IDR24trn of bonds as per indicative target, resulting in a high bid/cover ratio of 2.82x. Most of the incoming bids went to FR101 and FR100; the cut-offs of these bonds were near the lowest incoming bid levels.

MYR:

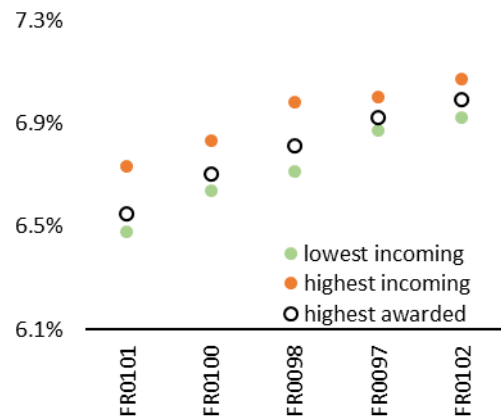
MGS underperformed USTs in the recent bond rallies as MGS stayed fairly stable. The first two auctions of the year were well received. The re-opening of the MYR3bn of 30Y MGS (with an additional MYR2bn via private placement) garnered a strong bid/cover ratio of 2.99x. The reopening of the MYR5bn of 10Y MGII also fetched a decent bid/cover ratio of 2.44x. We forecast MGS+MGII supply at MYR178-180bn in 2024, upon heavier maturities; the supply outlook is neutral. **We look for continued stability in short-end MGS yields** as the current spreads over OPR look fair while OCBC economists expect OPR to stay at 3% throughout this year.

The benchmark 3M KLIBOR has been easing since the start of the year. The rate had risen gradually through H2-2023 despite the stable OPR and reached some elevated levels. The recent adjustment shall be seen as a normalization; **we expect further normalization in KLIBOR with respect to OPR**, pushing 3M KLIBOR down to the 3.50-3.55% area in the latter part of the year. Outstanding Ringgit liquidity placed with BNM had been stable, standing at MYR142bn as of end November 2023, compared to MYR140bn at end October 2023.

SGD:

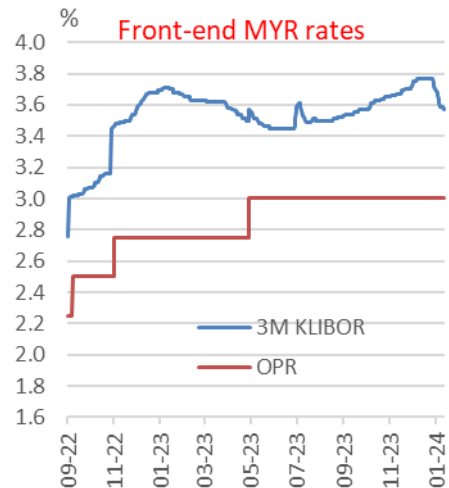
SGD rates underperformed USD rates in the broad downward moving starting from October, in line with our view. **We continue to expect SGD rates to lag on a downward move**, thereby partially normalizing SGD-USD rates differentials. We expect SGS-UST yield differentials to widen as well, mainly reflecting the stable nature of SGS. This year's SGS supply starts with the reopening of the 2Y bond, the size of which is to be announced on 23 January. Focus in Q1 may instead be on the reopening of the 20Y bond, which is on the regular calendar versus being an optional mini auction last year. There may be a mild steepening pressure on the 10s20s part of the curve nearer the time as investors position for the 20Y supply.

16 January IndoGB Auction



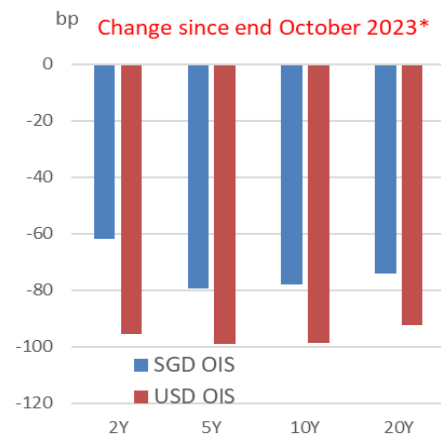
Source: DJPPR, OCBC Research

Front-end MYR rates



Source: Bloomberg, OCBC Research

Change since end October 2023*



Source: Bloomberg, OCBC Research
*as of 12 January 2024

At the front end, demand at recent MAS bill auctions was decent, at bid/cover ratios of more than 2x. **Bill cut-offs eased somewhat but stayed high mainly on the back of the higher forward points** which exerted upward pressure on implied SGD rates. Forward points and the basis have generally been moving to the right-hand side in a few Asian markets, amid supportive USD liquidity. The near-term outlook for bill yields is uncertain as the liquidity situation continues to evolve. Further ahead, the expected downward move in USD rates shall become the dominating factor, leading to a gradual downward move in front-end SGD rates and yields.

CNY:

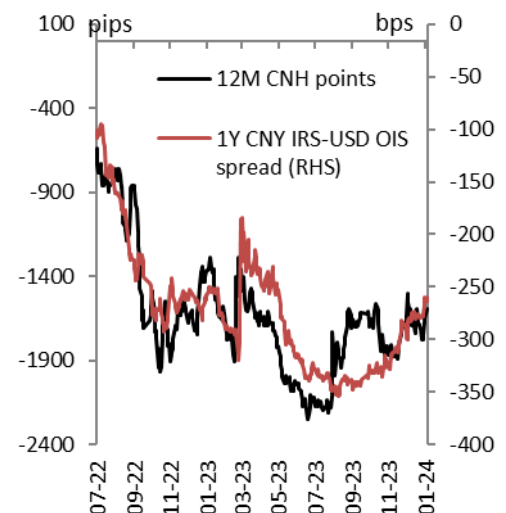
Repo-IRS rebounded as the year started, in line with our rates bottoming view. The 1Y MLF rate was kept unchanged at 2.50% while net MLF injection in the month was not big, at CNY216bn. Chance for an RRR cut may be seen as higher after the MLF operations. **Despite easing prospects, we maintain our medium-term upward bias to CNY rates and CGB yields** and eye 10Y CGB yield at the 2.70-2.80% area by year-end, on supply risk and as market shall ultimately respond to the better growth outlook resulting from various support measures although investors will need the data proving such improvement which means an uptrend in rates may not be established soon.

China registered bond inflows (excluding NCDs) of CNY123.98bn in December, the third month of inflows in a row. Most of the flows went to CGBs, followed by PFBs (policy financial bonds). **We have had a more sanguine outlook for China bond flows since the October outcome**, as we opined in our H1-2024 Outlook report and the December Interest Rate Monthly, *the flow prospect is likely turning for the better: 1/ CGB-UST yields differentials are likely to widen (become less negative) as UST yields fall while CGB yields are expected be relatively stable with a mild upward bias; 2/ positioning is likely on the light side after an extended period of outflows; and 3/ if implied RMB rates stay low, that would be constructive for inflows from asset swap perspective for certain tenors.* Looking ahead, we expect further widening in CGB-UST yield differentials.

On the FX swap curve, bidding interests are seen on and off at the front-end as liquidity remains one of the tools to smooth spot movement. Back-end remains primarily as a function of CNY-USD rates differentials and with potential upticks in US rates near-term, the curve may have a flattening bias near-term. Our medium-term view remains for a steepening in the FX swap curve (leaving out the very front-end) based on our respective USD rates and CNY rates expectations, and on our soft dollar view.



Source: CEIC, OCBC Research



Source: Bloomberg, OCBC Research

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