Interest Rates Monthly

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Look for next triggers for softer yields

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

Global Markets Research and Strategy

- **USD rates**. Uncertainty remains high on US policy front but given how the market had been set up, hope for an incremental approach with regards to tariffs did give market some relief. After the relief rally, we are looking for the next triggers for softer yields ahead. 10Y breakeven still hovered around the high end of range and we see room for some downward adjustment should PCE price index come in favourably. This week's coupon bond auctions will provide a better gauge on demand. At the front-end, investors may be reluctant to add much to rate cut expectation before the next rate cut materialises, or before official hints that the next rate cut may come sooner than what the market is currently pricing – such dovish surprise at the upcoming FOMC meeting cannot be ruled out.

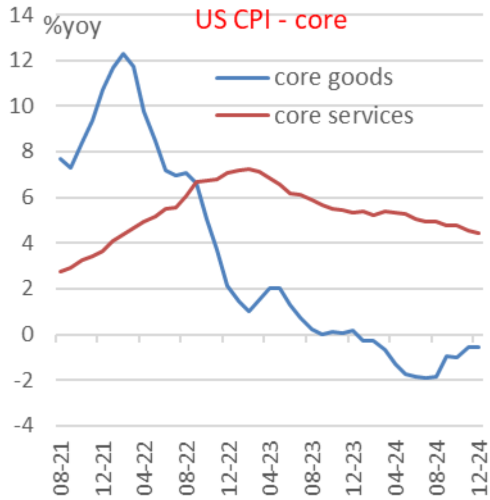
- **JPY rates**. BoJ raised the target for the overnight call rate by 25bps to 0.50% in line with our expectation; our base-case remains for two additional 25bp hikes this year. Given real yields are still negative, we continue to look for a gradual drift higher in yields over the coming months. Near-term, however, further upside to 10Y JGB yield may be limited without a break higher in 20Y JGB yield and/or 10Y JPY OIS.

- **IndoGBs** were given a lift upon BI policy rate cut; this happened just before the softer US core CPI print which has extended the broader bond market optimism. 10Y IndoGB-UST yield spread at around 245-250bps level appears stable; we see room for IndoGB yields to go lower upon any UST rally.

- **SGD rates**. Rates market reaction to MAS policy decision was muted, not least because the slope reduction had been partially in the price. We maintain a mild downward bias to SGD rates over the coming months premised on our lower USD rates view and assumed partial passthrough from USD rates onto SGD rates. 2Y SGS cut off at 2.82%, within our expected range. Spreads between MAS bills cut-offs and implied rates narrowed at recent auctions from elevated levels in December.

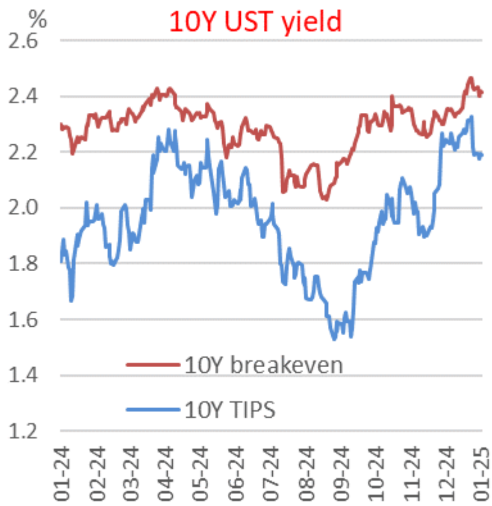
USD:

UST yields were a tad lower compared to a month ago, having earlier risen to recent highs upon the stronger-than-expected payrolls print. Triggers for the softening in yields of late included December CPI outcome and the absence of tariff imposition on Trump's inauguration day. On inflation, core CPI eased to 0.2%MoM in December, after staying at 0.3%MoM for four months in a row. Year-on-year, the disinflation trend in the services sector continued, including that in the rent of shelter component. Looking ahead, the base effect for headline CPI is favourable for Q1 YoY readings.



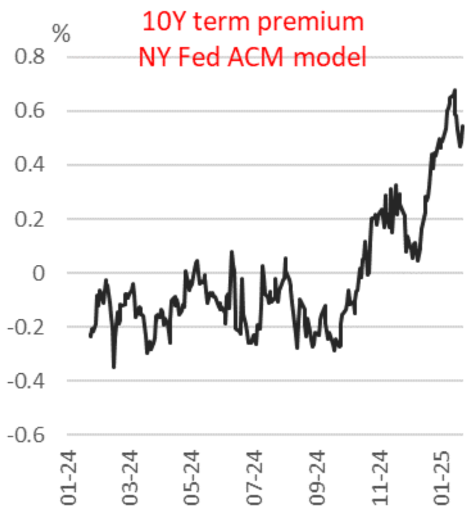
Source: CEIC, OCBC Research

UST yields fell on/after inauguration day as well, as an initial response. Granted, uncertainty remains high on US policy front, but given how the market had been set up – e.g. the hawkish repricing in Fed funds futures since October and the steady increase in the term premium, hope for an incremental approach with regards to tariffs did give market some relief. **After the relief rally, we are looking for the next triggers for softer yields ahead**. 10Y breakeven still hovered around the high end of range and we see room for some downward adjustment should PCE come in favourably. Meanwhile, the term premium was still at an elevated level with the 10Y term premium last at 0.5451% as estimated by NY fed's ACM model; this represented a cumulative increase of 73bps since 1 October which might be mostly attributed to Trump-related fiscal concerns. 10Y UST yield is moving near the 4.52% level that we have eyed with the next to watch at 4.45%; upside remains at 4.80% which was the recent high.



Source: Bloomberg, OCBC Research

At the front end, our base-case remains for a total of 75bps of Fed funds rate cut this year as: 1/the broader disinflation trend appears to have stayed intact; 2/ our expected rate cut profile already represents a well slower pace of easing compared to the 100bps of back-to-back rate cuts that had been delivered, and is consistent with the FOMC stance to bring rates gradually over time to a more neutral level; 3/ after all, current interest rate level is likely still restrictive. That said, investors may be reluctant to add much to rate cut expectation before the next rate cut materialises, or before official hints that the next rate cut may come sooner than what the market is currently pricing – **such dovish surprise at the upcoming FOMC meeting cannot be ruled out**. Fed funds futures last priced a total of 43bps of rate cuts this year, with a 25bp cut fully priced by the June meeting.

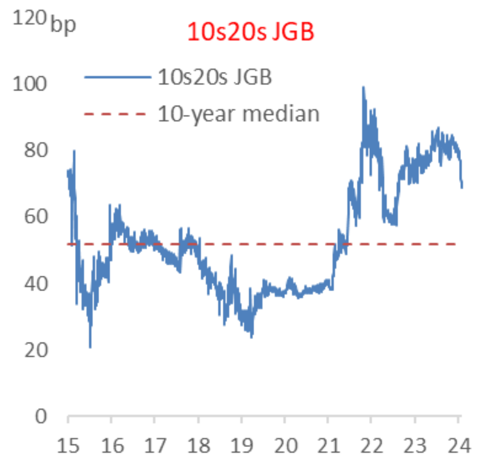


Source: Bloomberg, OCBC Research

With the recent relief rally in USTs, the curve flattened back slightly, from the recent peak of 43bps across the 2s10s segment to the latest 34bps. Our forecasts have put a spread at the 35-40bps area and as such **we are mostly neutral on the 2s10s spread at current level with a mild steepening bias**.

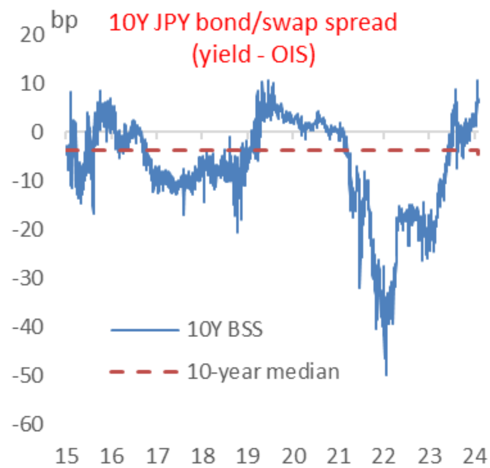
JPY:

BoJ raised the target for the overnight call rate by 25bps to 0.50% in line with our expectation, while a hike had also become market consensus running into the BoJ decision. Although the overall stance remains that the central bank will adjust the degree of monetary accommodation if their economic outlook is realised, it added "the likelihood of realising the outlook has been rising". This can be seen as a mild hawkish tilt, notwithstanding one dissident to the rate hike decision – Nakamura advocated waiting for confirmation of a rise in firms' earning power i.e. just a matter of timing. BoJ revised upward fiscal 2025 CPI forecast to 2.4% from 1.9% while keeping GDP forecast at 1.1%. At the post-meeting press conference, Governor Ueda said he was optimistic over the outlook for *shunto*, but again refrained from pre-committing to a rate hike path. Our base-case remains for two more 25bp hikes this year, and we have tentatively put one each in Q2 and Q3, which will then bring BoJ target rate to 1%.



Source: Bloomberg, OCBC Research

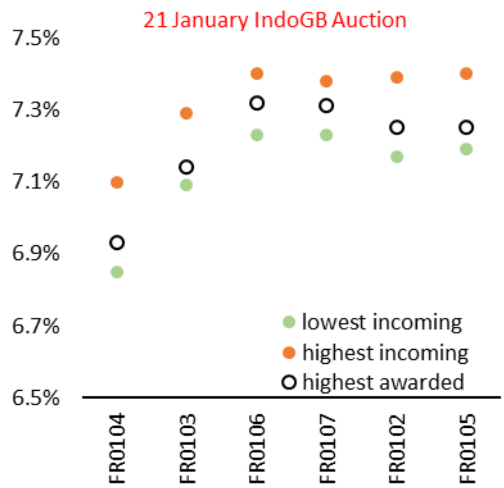
Latest JPY OIS pricing was around an additional 28bp hike by year end, which is less hawkish than our base-case. JGB yields traded a few bps higher upon BoJ decision with the 10Y yield approaching the 1.25% level that we have been eying. Given real yields are still negative – 5Y at around -0.99% for example, **we continue to look for a gradual drift higher in JGB yields** over the coming months. Near-term, however, further upside to 10Y JGB yield may be limited without a break higher in 20Y JGB yield and/or 10Y JPY OIS: 10s20s JGB spread was last at 67bps, not too far away from 10-year median of 52bps while the steeper curve may be justified; 10Y bond yield is a few bps higher than swap. For local investors, the pick-up from investing in USTs on an FX hedged basis has been improving, from negative to roughly flat now, as TONAR has gone higher while SOFR fell.



Source: Bloomberg, OCBC Research

IDR:

IndoGBs were given a lift upon BI policy rate cut; this happened just before the softer US core CPI print which has extended the broader bond market optimism. Demand at the latest conventional bond auction also improved. Incoming bid at the 21 January conventional bond auction was stronger at IDR54trn; IDR26trn of bonds were awarded as per indicative target with no upsize, however. To meet Q1 issuance target of IDR228trn when there was one fewer auction in the quarter compared to last year, individual auction sizes would need to be slightly bigger at IDR26-28trn for conventional bonds and IDR10-12trn for sukuk. Nevertheless, there may be leeway for below-target issuances in the quarter, with the recent successful global bond issuances including the one for prefunding.



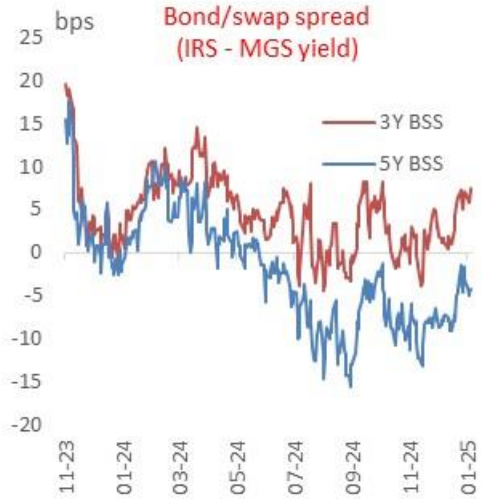
Source: DJPPR, OCBC Research

Flow-wise, the hefty single-day inflow of IDR7.8trn on 23 January undid most of the outflows registered year-to-22 January; foreign holdings stood at IDR874.7trn or 14.35% of outstanding. Meanwhile, YTD banks and non-bank domestic investors increased holdings. Overall, supply-demand is roughly balanced.

10Y IndoGB-UST yield spread at around 245-250bps level appears stable; we see room for IndoGB yields to go lower upon any UST rally. Short-end bonds have also garnered some support from the recent BI policy rate cut and softening in SRBI rates. At the 24 January auction, SRBI rates (average) came in at 6.723%, 6.748% and 6.838% for 6M, 9M and 12M tenors respectively; these rates had fallen by cumulative 34bps, 35bps and 39bps over the past two auctions, roughly in line with the lower implied IDR rates upon lower US rates and lower forward points.

MYR:

MGS continued to trade in a stable manner, through the ups and downs in UST yields. Auctions this year thus far were well-received; the 15.5Y new MGII garnered a bid/cover ratio of 4.29x amid light supply. We expect 2025 gross MGS+MGII supply in the range of MYR163-164bn with the key swing factor being bills issuances. Bond maturities are the heaviest in Q3 followed by Q4, while there is no maturity in Q2; quarterly gross issuances may be adjusted accordingly to smooth out net supply across the quarters. Bond/swap spreads (IRS – yield) have been trending upward in line with our expectations; at current levels, any further bond outperformances against swaps may be more limited.

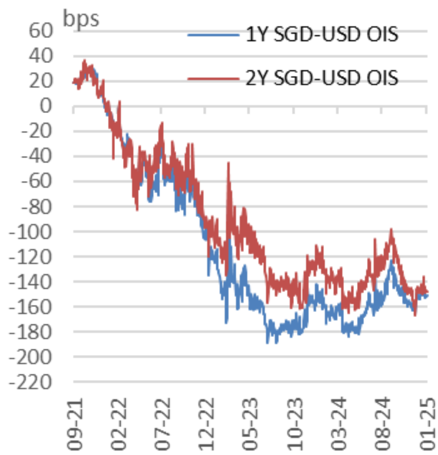


Source: Bloomberg, OCBC Research

KLIBORs eased from elevated levels observed towards year-end, with the 3M last at 3.67% around the 3.65% level we expect for this quarter. We have noted that with outstanding Ringgit liquidity placed with BNM settling at around the MYR100bn level versus higher levels in previous years, the spread between KLIBOR and OPR may not return to multi-year averages soon.

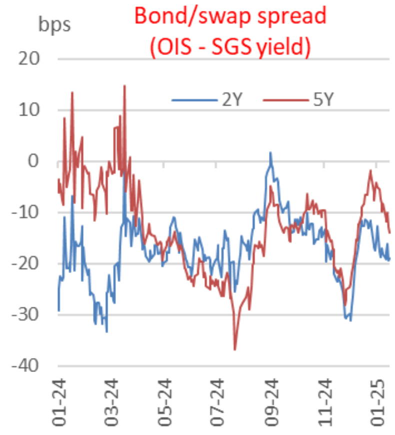
SGD:

The 3M and 6M forward points went up mildly upon MAS decision on 24 January but the reaction did not last; points were subsequently offered down. SGD OIS edged lower mostly following USD rates movements. Overall, reactions in the points and hence short-end SGD rates were muted, not least because MAS decision to reduce the S$NEER slope slightly had been partially in the price. Looking ahead, **we maintain a mild downward bias to SGD rates over the coming months** premised on our lower USD rates view and assumed partial passthrough from expected downward move in USD rates onto SGD rates as per historical pattern. We look for SGD rates to edge gradually lower to the 2.50-2.65% area for most tenors by year end.



Source: Bloomberg, OCBC Research

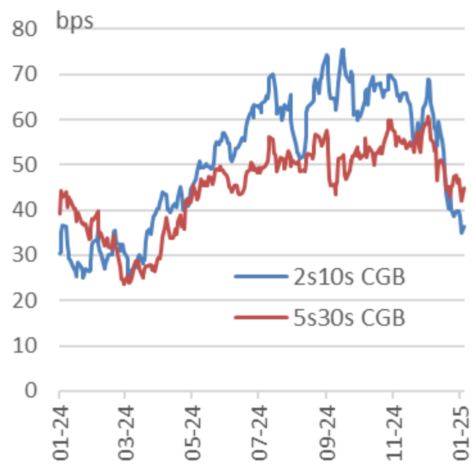
The reopening of 2Y SGS (MD) on 27 January cut off at 2.82%, which was around 20bps above 2Y SGD OIS, within our expected range of 17-23bps. The recent 1Y T-bills cut off at 2.95%, with bid/cover ratio lower at 1.87x versus 2.83x prior. The 1Y cut-off was mildly above expectation; the latest 6M and 1Y T-bill cut-offs implied a 6M6M rate of 2.87% which appeared a bit too high to us, i.e. attractive. On bills side, the 1Y tenor is probably seen as long and its auction result may reflect preference for 6M T-bills. Bill yield spreads over implied rates in the range of 15-25bps appear to be the acceptable levels for now. Recent MAS bills cut-offs also settled at levels which were around 19-24bps above implied SGD interest rates, from elevated levels observed in December. Cut-off spreads over implied rates are less stable for 4W and 12W MAS bills than longer tenor instruments, as they are relatively more affected by the prevailing liquidity conditions.



Source: Bloomberg, OCBC Research

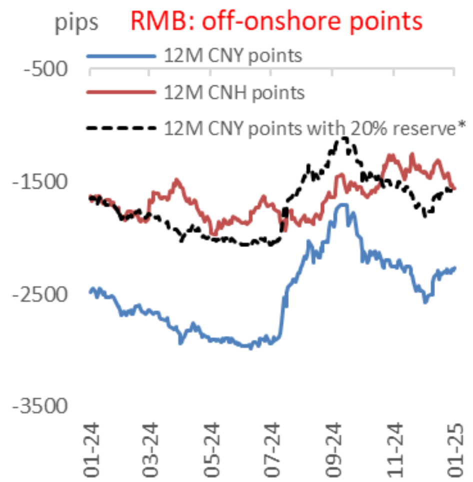
CNY:

Short-end CNY rates and CGB yields rebounded from lows attained in late December amid a tightening of liquidity. Thereafter, PBoC injections over recent days – mainly via 14-day reverse repos - provided support to liquidity on aggregate. On 24 January, PBoC granted a small amount of CNY200bn of MLF, in line with the policy intention to fade the facility. Meanwhile, the chance for an imminent RRR cut is seen as low given the focus on liquidity injections via reverse repos.



Source: Bloomberg, OCBC Research

On bond side, the recent flattening of the CGB curve was partly due to a tightening of liquidity at the short end. PBoC halted bond purchases under open market operations, as bond supply fell short of demand; we earlier wrote "the CGB curve may flatten further as initial reaction when short-end bonds also appear to be running too much ahead of the curve in terms of pricing in monetary easing". In the broader scheme of things, the curve may re-steepen from here, against the backdrop of monetary easing and fiscal stimulus; the multi-month target could be a spread of 45-50bps for the 2s10s segment.



Source: Bloomberg, OCBC Research
*estimation of full impact of 20% FX risk reserve

The gap between offshore-onshore FX swap points has narrowed, in line with our expectations. For example, the 12M forward point gap has narrowed from more than 1000pips earlier in the month to the latest 740pips, which is similar to what the full impact on the 20% FX risk reserve would imply. Not all transactions are subject to the risk reserve and hence some further narrowing in the off-onshore points cannot be ruled out. Taking a step back, some recent development on cross-border flows may lead to narrower offshore-onshore gaps in rates and points. One of the recent measures announced by the PBoC and HKMA is the HKMA RMB Trade Financing Liquidity Facility. One key feature of this Facility is that banks in Hong Kong can access RMB funding with reference to onshore CNY rates (plus a spread) for trade financing purposes; CNY rates are generally lower than CNH rates.

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, CFA
Credit Research Analyst
ezienhoo@ocbc.com

Wong Hong Wei, CFA
Credit Research Analyst
wonghongwei@ocbc.com

Chin Meng Tee, CFA
Credit Research Analyst
mengteechin@ocbc.com