GLOBAL MARKETS RESEARCH

Interest Rates Monthly

6 November 2023

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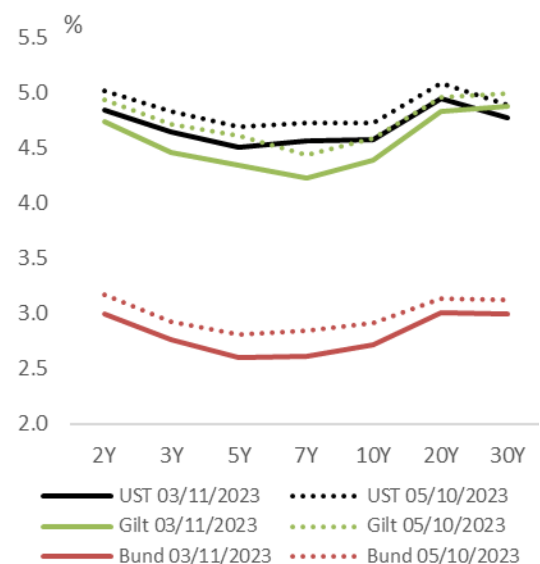
Central bank policy and bond supply

- **USD rates.** The latest FOMC statement/Powell's press conference and softer data prints have reinforced our view that there will be no more rate hike in this cycle. On Treasury's refunding plan, net borrowing via marketable securities for Q4-2023 has been revised downward to USD776bn from USD852bn. To retain flexibility in issuance strategy, US Treasury has planned for larger increases in the sizes of auctions of the 2Y, 3Y and 5Y bonds than those of the longer tenors. The recent retracement lower in UST yields was in line with our directional view. We look for consolidation near-term, and further downward move in yields over the coming months/quarters.

- **BoE** kept its Bank Rate unchanged. With one more MPC member moving away from supporting a rate hike, and the downward revision in the growth outlook, we now see the chance of another 25bp hike as slim; our base-case is for no more rate hike in this cycle. We prefer to stay neutral at front-end bond/swap spreads before OBR's Autumn Statement on 22 November.

- **BoJ** scrapped the strict 1% cap on the 10Y JGB yield, now seeing 1% as a "reference". YCC with increasing flexibility means the 10Y JGB yield can be allowed to rise above 1%. Given the higher levels that the 10Y JPY OIS and the 20Y JGB yield reached recently, we see the next resistance for the 10Y JGB yield (i.e. the support for the bond) as having gone higher to the 1.10-1.20% area. We still expect the BoJ, at some point in time likely before mid-2024, to hike the policy-rate balance rate from -0.1% to zero.



Source: Bloomberg, OCBC Research

- **RBA** is likely to hike its Cash Rate by 25bps on 7 November. Q3 CPI came in firmer than expected. In YoY, trimmed mean decelerated to 5.2% against expectation for 5.0%; in MoM, trimmed mean accelerated to 1.2% while the previous figure was revised mildly upward to 1.0%. PPI also picked up to 1.8%QoQ in Q3. We have kept a final 25bp hike in our expected profile for the RBA and we now think this 25bp hike is likely to be delivered at the November MPC meeting. The central bank may not gain too much insight into the inflation and growth picture by waiting for another month.

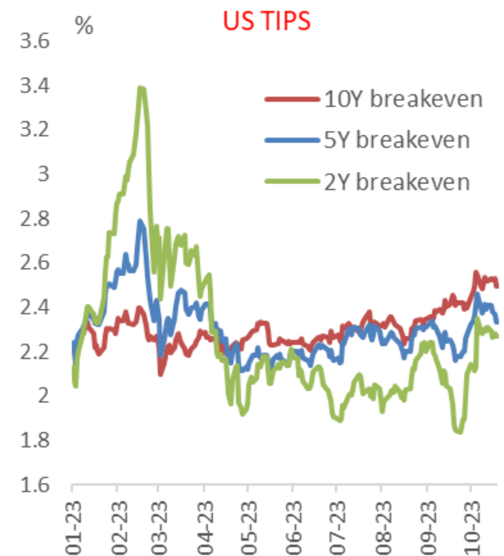
- **BNM** kept OPR unchanged at its November MPC meeting; OCBC economists expect a prolonged hold. Earlier, fiscal deficit has been budgeted at MYR85.4bn for 2024; we forecast gross MGS+MGII supply at MYR178-180bn for 2024, assuming fairly stable outstanding T-bills (MTB+MITB); key risk to our supply forecast stems from how the MoF would like to adjust outstanding T-bill amounts.

- **China** has raised its 2023 budget deficit thereby increasing supply of CGBs by RMB1trn; market holds expectation for liquidity injection from the PBoC to buffer the impact of additional bond supply.

USD:

FOMC review and outlook. The FOMC has kept its Fed funds rate target range unchanged at 5.25-5.50% at the November meeting. A few things to note:

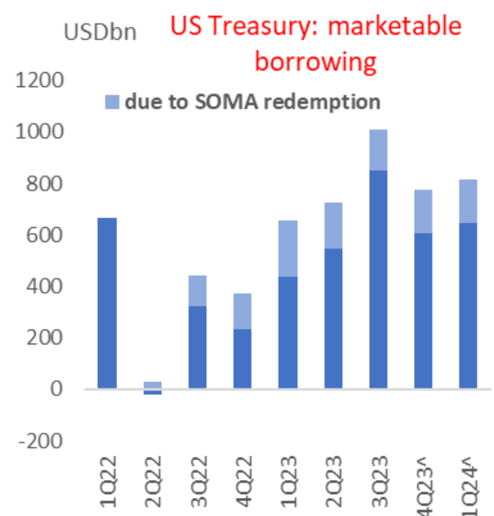
1/ *Tighter financial condition*. The FOMC statement commented that "tighter financial and credit conditions for households and businesses are likely to weigh on economic activity, hiring, and inflation" – "financial" is added to "credit" regarding the tighter conditions, apparently referring to the increases in UST yields. The rest of the statement is fairly similar to the September statement.
2/ *Powell sounded less hawkish*. Despite that Powell still does not rule out the possibility of further tightening, he did sound less hawkish – or dovish in relative terms. He said higher yields are showing as higher borrowing costs for households and business; longer term inflation expectation remains well anchored; the Committee has not made a decision for December - this should even be seen as "dovish", as the September dot-plot points to a 25bp hike in December, and this leads to the next point:
3/ *The efficacy of the dot-plot decays*. Powell answered at length about the dot-plot: "The dot-plot is a picture in time of what the people in the Committee thinks is likely to be an appropriate monetary policy in light of their own personal economic forecast" and it is not "a plan that anybody has agreed to" and "that is a forecast that would change". The "efficacy of the dot plot probably decays over the 3-month period between that meeting and the next meeting". This is precisely what we have been highlighting, that the dot-plot represents individual FOMC members' own forecasts and past dot-plot were not particularly accurate. By saying members could, 6 weeks later, "say I wouldn't write down that dot" as they could change mind, Powell almost told the market to ignore the dots that point to a final 25bp hike, in our view.



Source: Bloomberg, OCBC Research

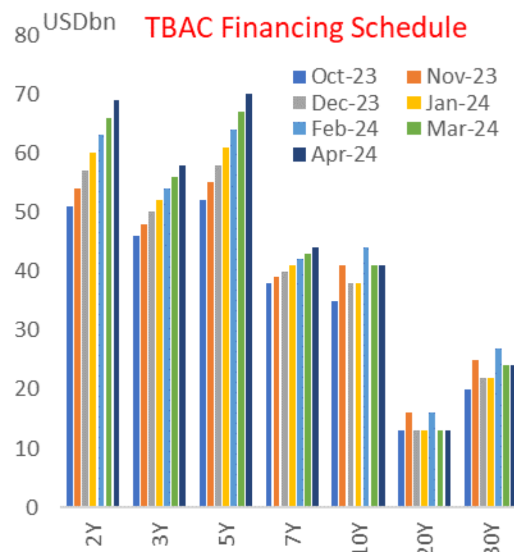
We hold onto our view that there will be no more Fed rate hike in this cycle. We have penciled in 100bps of rate cuts for 2024, probably starting in one of the two FOMC meetings in Q2-2024. This will bring the Fed funds rate target range to 4.25-4.50% by end-2024. As we have flagged before, risk to our Fed funds rate forecasts is to the downside.

US Treasury refunding plan. Net borrowing via marketable securities is estimated at USD816bn for Q1-2024; that for Q4-2023 has been revised downward to USD776bn from USD852bn "largely due to projections of higher receipts somewhat offset by higher outlays." With the flexibility given by the narrower deficit estimates, US Treasury reduced net bill supply for Q4, while the increase in net coupon bond supply is not as much as initially planned/market had expected. Q4 net marketable borrowing is now planned at USD776bn – to be shared by USD316bn of net coupon supply and



Source: US Treasury, OCBC Research
^US Treasury estimates

USD460bn of net bill supply. Q1-2024 net marketable borrowing is planned at USD816bn, via USD230bn of net coupon supply and USD586bn of net bill supply. Note these estimates have the assumption that the TGB balance ends 2023 and Q1-2024 at USD750bn – which is on the high side and shall provide some buffer should some drawdowns be needed, in our view.



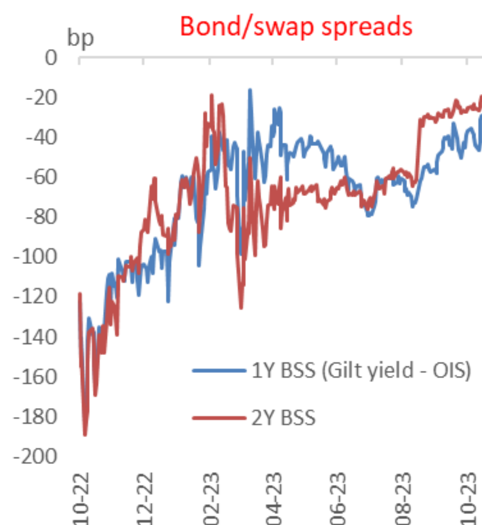
Source: US Treasury, OCBC Research

To retain flexibility in issuance strategy, the Treasury Borrowing Advisory Committee suggested the Treasury "to skew increases in issuance toward tenors which have less sensitivity to term premium increases, and ones that benefit from greater liquidity." The Committee "supported meaningful deviation" from the historical recommendation for 15-20% T-bill share. US Treasury has planned for larger increases in the sizes of auctions of the 2Y, 3Y and 5Y bonds than those of the longer tenors.

US yields. This has given the bond market some relief and mitigate/reverse some of the steepening momentum of the UST curve. The recent retracement lower in UST yields was in line with our directional view. Notably, the decreases in nominal yields were mainly driven by lower real yields, which we had been looking for. From here, room for yields to go further lower in the near term may be limited, unless the data surprise a lot to the downside. Looking further ahead, as time goes by, the rate cuts currently being priced will be increasingly factored into the pricing of short-end bonds, thereby pointing to further downside to yields over the coming months/quarters, even without a further shift in expectation. For the UST curve to steepen meaningfully from here, some further easing at front-end yields is probably needed.

GBP:

The Bank of England kept its policy Bank Rate unchanged at 5.25% with a 6-3 vote at the November MPC meeting. Three members preferred to hike the Bank Rate versus four members at the September MPC meeting. While the BoE sounded more downbeat on the economic growth prospect, it has pushed the timeline for inflation to return to the 2% target to end-2025 from Q2-2025. Gilts rallied post meeting, as market focused on the downbeat growth outlook, with mid to long-end Gilts outperforming probably also taking inspiration from the global market. BoE revised GDP forecasts lower for 2023 (from 0.9% to 0.6%), 2024 (0.1% to 0.0%) and 2025 (0.5% to 0.4%); CPI inflation forecasts were revised modestly lower for 2023 (from 4.9% to 4.6% for modal inflation) but notably higher for 2024.



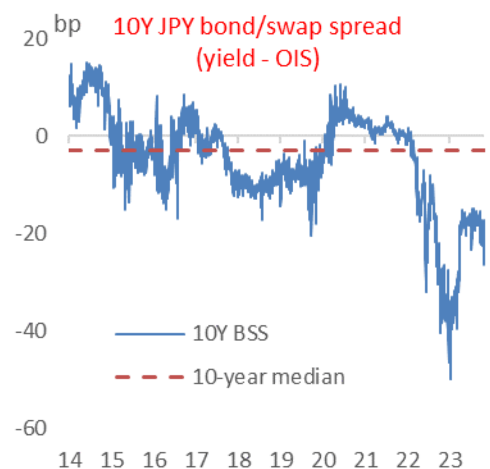
Source: Bloomberg, OCBC Research

While BoE saw risk to their inflation projection to the upside, disinflation (in YoY terms) is nevertheless expected to continue. With one more MPC member moving away from supporting a rate hike, and the downward revision in the growth outlook, **we now see**

the chance of another 25bp hike as slim. Our base-case is for no more rate hike in this cycle. Next to watch will be OBR's Autumn Statement on 22 November, to gauge if Gilts will underperform GBP OIS further, when GBP OIS pricing of the monetary policy outlooks appears mostly fair – around 33% chance priced for a 25bp hike by the February MPC meeting. For now, we prefer to stay neutral at front-end bond/swap spreads.

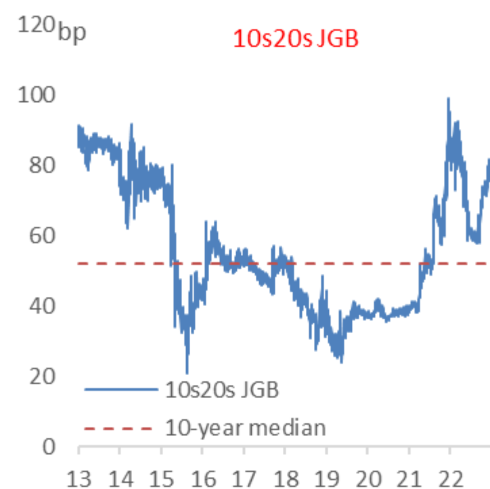
JPY:

BoJ scrapped the strict 1% cap on the 10Y JGB yield, now seeing 1% as a "reference". At the conclusion of the October 31 MPC meeting, the BoJ said it would "further increase the flexibility in the conduct of yield curve control". Specifically, the BoJ no longer have a pre-determined fixed offer rate under its daily fixed rate bond-buying operations. The BoJ "will determine the offer rate for fixed-rate purchase operations each time". So, before this tweak, YCC strictly capped 10Y JGB yield at 1% by fixed-rate purchase operations; now, **YCC with increasing flexibility means the 10Y JGB yield can be allowed to rise above 1% although 1% is still the reference**. The 10Y JGB yield, after a brief dip upon some initial confusion regarding the YCC policy, rose to an intra-day high of 0.95% on the BoJ decision day. Ueda said in the press conference that if the gain in yields reflects fundamentals, the BoJ "will allow that".



Source: Bloomberg, OCBC Research

JGB yields have since retraced lower taking cue from the UST market. Still, given the recent higher levels in the 10Y JPY OIS and the 20Y JGB yield, we see **the next resistance for the 10Y JGB yield** (i.e. the support for the bond) as having **gone higher to the 1.10-1.20% area**. This may explain why the BoJ is reluctant to put an explicitly higher cap for the 10Y yield – as it may not go too much above 1% for now. We still expect the BoJ, at some point in time likely before mid-2024, to hike the policy-rate balance rate from -0.1% to zero which shall be better seen as moving from a three-rate tiering system to a two-rate tiering system.

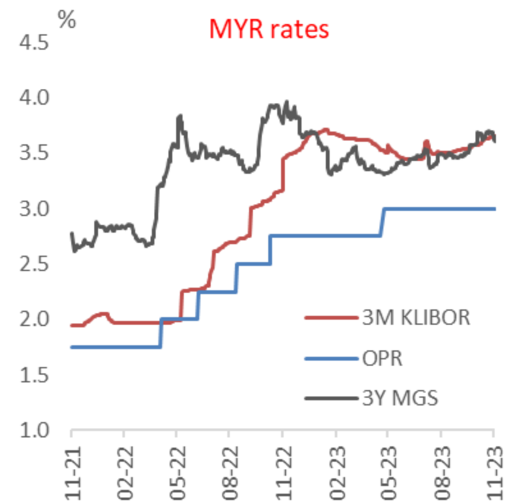


Source: Bloomberg, OCBC Research

The BoJ revised upward inflation forecasts for fiscal years 2023, 2024 and 2025, notably for core CPI in fiscal 2023 and 2024, and also for core core CPI in 2023. The central bank now expects core CPI at 2.8% (previous 2.5%) and core core CPI at 3.8% (previous 3.2%) in fiscal 2023; core CPI at 2.8% (previous 1.9%) and core core CPI at 1.9% (previous 1.7%) in fiscal 2024.

MYR:

Over the past weeks, front-end MGS underperformed USTs probably amid mildly tight MYR liquidity and as investors required some premium against the risk of monetary tightening in view of surprise policy rate hikes by some other central banks in the region. BNM kept OPR unchanged at its November MPC meeting. OCBC economists continue to expect BNM to keep its OPR on hold for an extended period, while 2024 budget deficit is narrower than expected 2023 deficit. Short-end MGS shall stay resilient. And we expect KILBORs to grind slowly lower from here. First, the spread between 3M KLIBOR and OPR has widened, likely reflecting some premium against the risk of monetary tightening – this risk premium may be partially priced out. Second, with the planned reduction in outstanding T-bills this quarter, liquidity in the banking system may improve. A majority of bills were bought by banks (which held 80% of outstanding at end-June), while the investor base for MGS+MGII is more diversified (banks held less than one-third of MGS+MGII combined). It may be fair to assume that not all the liquidity from T-bills will be re-invested into bonds; hence, interbank liquidity may improve at the margin.



Source: Bloomberg, OCBC Research

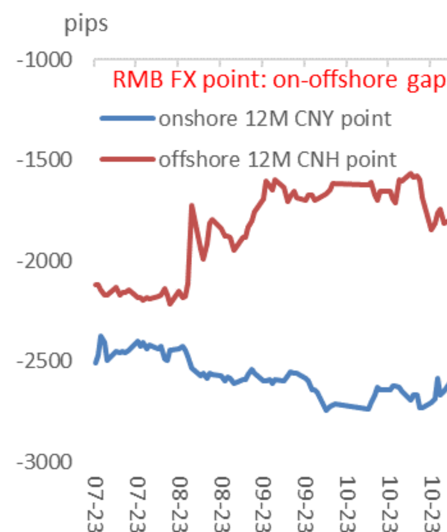
Fiscal deficit is budgeted at MYR85.4bn for 2024, which is narrower than the estimated MYR93.24bn in 2023. Maturities of MGS and MGII are each heavier in 2024 than in 2023. On top of these, MYR5.5bn worth of SPK matures in 2024 (in February) versus MYR3.9bn matured in 2023. Hence, **we forecast gross MGS+MGII supply at MYR178-180bn for 2024**, assuming fairly stable outstanding T-bills (MTB+MITB). Key risk to our supply forecast stems from how the MoF would like to adjust outstanding T-bill amounts. MoF said they aim to "manage refinancing risk by reducing the issuance of short-term papers" in explaining the expected changes in the composition of T-bills versus bonds in total outstanding debt for 2023. There is uncertainty as to whether the MoF will continue – and to what extent - with this borrowing strategy in 2024, which may point to upside to gross MGS+MGII supply. Nevertheless, budget deficit in 2024 is after all narrower than that in 2023, pointing to mildly smaller net supply of MGS, MGII and T-bills combined.

CNY:

CNY rates eased in late October while CGB yields edged up marginally. China has raised its 2023 budget deficit thereby increasing supply of CGBs by RMB1trn, but market holds expectation for liquidity injection from the PBoC to buffer the impact of additional bond supply which may explain the softness in repo-IRS. In Q1-Q3 2023, net CGB issuances amounted to CNY2.374trn, compared to the now wider budget deficit of CNY4.88trn, pointing to CNY2.5trn of net supply in Q4. We see heightened chance of an RRR cut which would be helpful as a 25bp cut can already release liquidity which is enough to cover a large portion of the additional

bond issuances. Outsized MLF cannot be ruled out, especially if there is no RRR cut.

CNY rates are stuck between higher bond supply/other payments and expectation for liquidity injections. Meanwhile, the recent weak PMIs mean the improvement in China sentiment may not be a one-way train. Rates may trade soft upon liquidity injections but **beyond short-term market reactions, the additional budget shall add to the upward momentum in CNY rates** and CGB yields through two channels: higher bond supply and presumably a better economic outlook. In the offshore market, implied CNH rates have eased a lot in recent sessions, as China sentiment improved and pressure on the RMB subsided. Volatility at the front-end may return should sentiment turn for the worse and/or RMB come under renewed depreciation pressure, as tightening CNH liquidity remains as one of the ways to smooth FX movement. At the back end, the lower onshore CNY curve shall act as a pulling factor for the offshore CNH DF curve.



Source: Bloomberg, OCBC Research

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