GLOBAL MARKETS RESEARCH

Interest Rates Monthly

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Central banks in focus: policy rates; liquidity operations

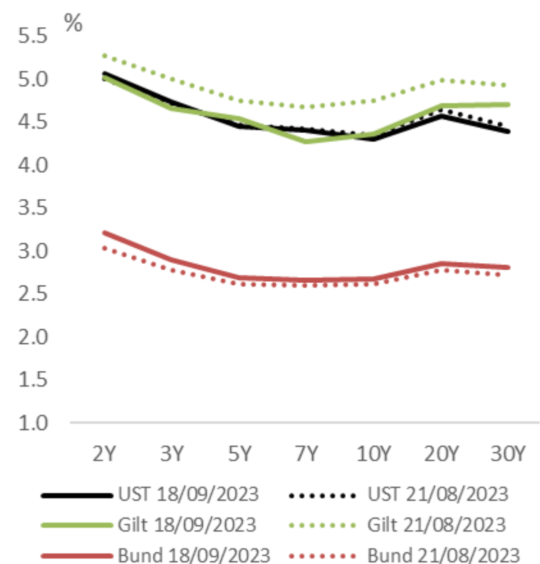
- **USD rates**. UST yields were mildly higher compared to a month ago, as market prepared for a pause at the September FOMC meeting while continuing to price some chance of a final rate hike in this cycle. Apart from the Fed funds rate decision, the FOMC will update its economic projections together with the dot-plot, which may carry important messages to any tilt in the consensus among the Committee. The 2023 median dot is expected to still reflect an additional rate hike to keep the November and December FOMC meetings live; what would be seen as less hawkish is when one or more of those dots at median level move lower. A more important driver for short-end USTs is the pricing for 2024 and in this regard, there is a high uncertainty as to where the 2024 dots and hence the 2024 median dot will go, in either direction.

- **GBP rates**. We expect a 25bp hike at the September MPC meeting. While the BoE may not give a strong hint – as the ECB did – on the potential end of the rate hiking cycle, we are more inclined to believe that this expected hike will be the last one in this cycle. Gilts further underperformed GBP OIS as the rates market pared back rate hikes expectation. There is room for the BoE to up QT pace; but anything within GBP90bn shall be seen as mostly neutral. On balance, we do not extend our multi-month view of Gilt underperformance against swaps from here.

- **EUR rates**. The ECB hiked its policy rates by 25bps in line with our expectation. The key quote from the statement is "the Governing Council considers that the key ECB interest rates have reached levels that, maintained for a sufficiently long duration, will make a substantial contribution to the timely return of inflation to the target." This is a strong hint that there will be a long period of pause, if not an end, to rate hikes. Our base-case is there will be no more rate hike in this cycle.

- **SGD rates**. Month-to-date, the 3Y and 4Y SGD OIS have been paid up more compared to other tenors, as we last commented that the 2Y to 4Y rates "may attract some residue hedging flows". At current levels, the 2Y and 3Y rates are still relatively low on the curve, but the differences with other tenors have narrowed somewhat. The 10s15s and 10s20s parts of the SGS curve have re-flattened after the 50Y supply was digested; we expect these segments to stay inverted.

- **CNY rates.** Recent economic data point to some stabilization in economic activities, which shall set a floor to CNY interest rates. For a meaningful turnaround in CNY-USD rates differentials, however, easing in USD rates will be required. In offshore, we continue to caution against sporadic tightening in CNH liquidity, but back-end CNH points/rates shall be better anchored.

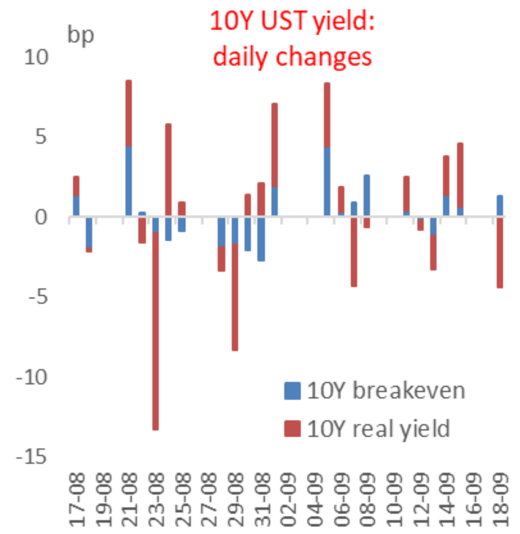


Source: Bloomberg, OCBC Research

USD:

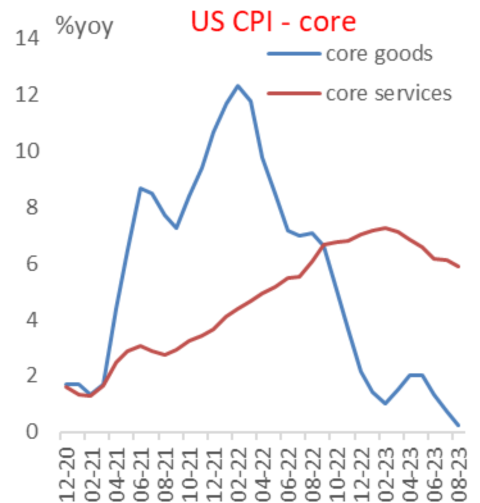
The UST yields were mildly higher compared to a month ago, as market prepared for a pause at the FOMC meeting while continuing to price some chance of a final rate hike in this cycle. Apart from the Fed funds rate decision, the FOMC will update its economic projections together with **the dot-plot,** which may carry important messages to any tilt in the consensus among the Committee. The 2023 median dot is expected to still reflect an additional rate hike to keep the November and December FOMC meetings live; what would be seen as less hawkish is when one or more of those dots at median level move lower which will then signal a lower conviction among the committee that they need to hike rate further. Market is split as to whether the Fed will deliver a final 25bp hike in this cycle, while our base-case is there will be no more hike in this cycle.

A more important driver for short-end USTs is the pricing for 2024. In this regard, the 2024 median dot is also something to watch – for the direction of any move instead of the level, as market pricing has not followed the level closely. The 2024 median dot at the June review reflected 125bps of cuts from the 2023 median dot, or 100bps of cuts from the current Fed funds rate target range. Market pricing has recently turned more hawkish, pricing in 75bps of cuts from current level. There is a high uncertainty as to where the 2024 dots and hence the 2024 median dot will go, in either direction. We expect a fair bit of volatility in USD rates around the FOMC decision.



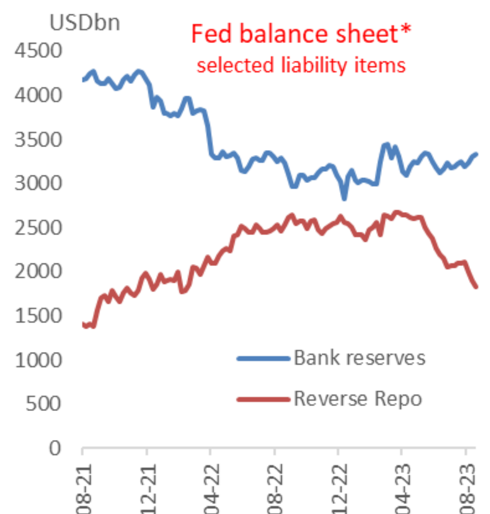
Source: Bloomberg, OCBC Research

US CPI. Gasoline price inflation was the largest contributors to the pick-up in headline MoM inflation. In YoY terms, the energy index rose 5.6%, of which the gasoline index rose 10.6%. More importantly, YoY disinflation continued to be reflected in core readings, as both core goods and core services inflation eased. Within core services, rent of shelter - which has a 34.4% weight to the overall CPI basket, increased by 7.33%YoY in August, extending the easing since March which registered an 8.26%YoY increase. Prospect is for some further easing in core readings in YoY terms for the months ahead.



Source: CEIC, OCBC Research

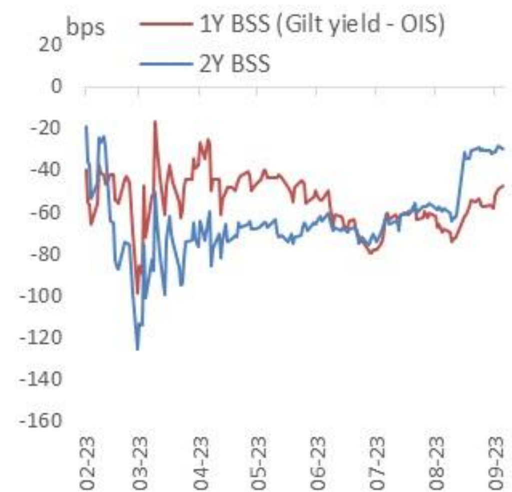
USD liquidity. Usage at the Fed's reverse repos have fallen further over the past month; funds parked at the o/n reverse repo stood at USD1.401trn as of 15 September, USD411bn lower than the recent peak of USD1.812trn on 22 August. During the same period, USD261.6bn of bills were settled and USD134.9bn of bonds were settled. It appears that the liquidity mobilised from the Fed's reverse repos have not only helped absorb bills supply, but probably some bond supply as well, although we cannot trace the exact destination of these funds. On an aggregate level, liquidity has stayed supportive. The rest of the monthly brings USD15bn of 10Y TIPS and USD24bn of 2Y FRN supply.



Source: Bloomberg, OCBC Research
*as of 13 September

GBP:

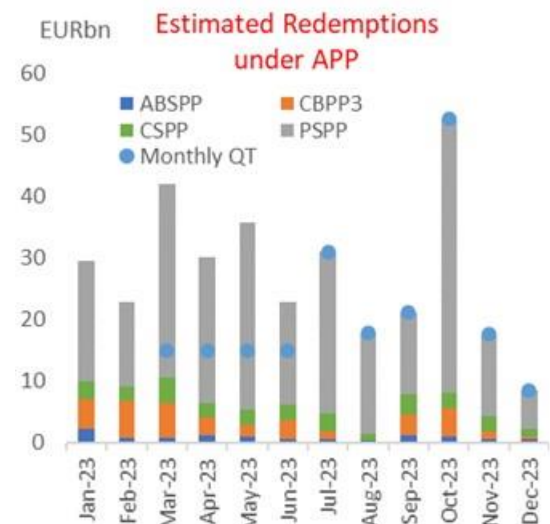
While we are approaching the end of the rate hiking cycle, peak rate is not confirmed yet. We expect a 25bp hike at the September MPC meeting. The BoE may not give a strong hint – as the ECB did – on the potential end of the rate hiking cycle, but we are more inclined to believe that this expected hike will be the last one in this cycle. GBP OIS pricing has eased, to a peak rate of 5.5% from around 6% priced a month ago. We last commented "there may still be some room for Gilts to further underperform swaps, but the move is likely to be slow". Gilts did further underperform GBP OIS and the pace was not slow. The MPC will also vote at the September meeting on the QT target for the next 12 months from October. There is room for the BoE to up the QT pace; but anything within GBP90bn shall be seen as mostly neutral. On balance, we do not extend our multi-month view of Gilt underperformance against swaps from here.



Source: Bloomberg, OCBC Research

EUR:

The ECB hiked its policy rates by 25bps in line with our expectation while market had been split between a 25bp hike and a hold. The central bank has kept its QT plan intact as we had expected, but there had been some expectation for a quickening of the pace. The key quote from the statement is "based on its current assessment, the Governing Council considers that the key ECB interest rates have reached levels that, maintained for a sufficiently long duration, will make a substantial contribution to the timely return of inflation to the target." This sentence did not appear in the July Statement. This is **a strong hint that there will be a long period of pause, if not an end, to rate hikes**. Our base-case is there will be no more rate hike in this cycle. EUR OIS price a 28% chance of another 25bp hike by the December MPC meeting, which is better seen as an insurance that the market is keeping against the risk of another interest rate hike, instead of the consensus for such.

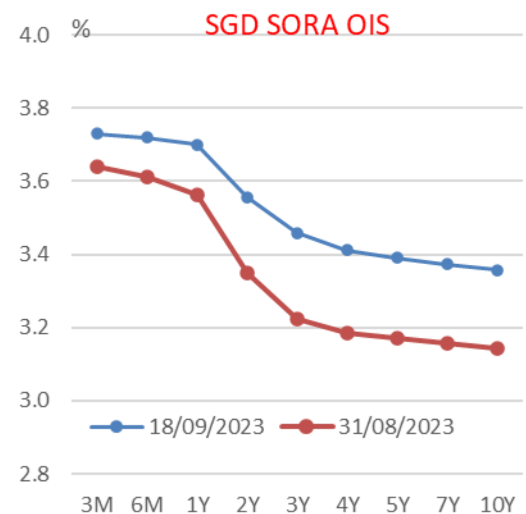


Source: ECB, OCBC Research

Regarding APP, the statement simply describes what has been happening, that "the Eurosystem no longer reinvests the principal payments from maturing securities." Hence, passive QT continues. APP maturity (which will be the QT amounts) is relatively heavy in October at an estimated EUR52.2bn, but smaller at EUR17.5bn in November and EUR8.6bn in December. A quickening in QT pace before year-end would require active bond sales and/or rundown in PEPP holdings which does not appear to be the near-term plan. Going into H1-2024, maturity averages EUR30.7bn a month which represents a quicker pace than in the Jul-Dec 2023 period even if ECB keeps passive QT. That said, the current policy to reinvest the principal payments from maturing securities under PEPP until at least end-2024 looks somewhat dovish and **risk is this end-2024 timeline will be brought forward**.

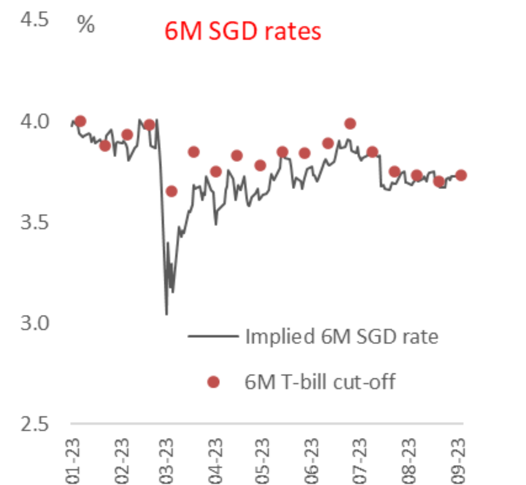
SGD:

SGD OIS has been on an uptrend since the start of the month with the curve steeper across 3M/4Y. The 3Y and 4Y SGD OIS have been paid up more compared to other tenors, as we last commented that the 2Y to 4Y rates "may attract some residue hedging flows". At current levels, the 2Y and 3Y rates are still relatively low on the curve, but the differences with other tenors have narrowed somewhat. Short-end (up to 2Y) SGD-USD rates spreads turned less negative, but this does not appear to be an established trend yet. It has been our medium-term view that SGD-USD OIS differentials shall become less negative. The momentum can become stronger if USD rates start to ease, more so if it is coupled with MAS easing.



Source: Bloomberg, OCBC Research

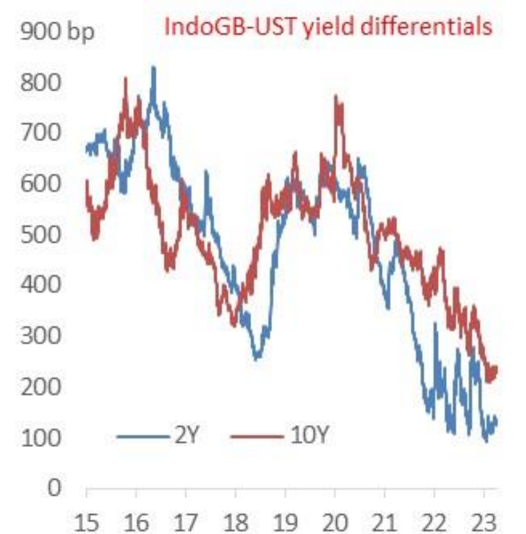
Demand for SGD papers has stayed strong. The latest 6M T-bill sales on 14 September attracted decent demand at a bid/cover ratio of 2.03x, which was similar to the 2.04x at the 31 August auction. Cut-off came in at 3.73% which was in line with expectation and near the 6M implied SGD rate. The 2Y SGS (reopen) on 29 August also saw good demand with a high bid/cover of 2.53x; cut-off at 3.56% was below pre-auction market trading levels. Separately, SGD2.8bn of the 50Y green SGS (infra) was sold via syndication. The size of the reopening of 30Y SGS (infra) will be announced on 20 September; we expect it at around SGD2bn which will bring full year gross issuance to SGD23bn. The 10s15s and 10s20s parts of the SGS curve have re-flattened after the 50Y supply was digested. This 30Y SGS (infra) auction on 27 September is the last auction of the year. With a lack of fresh supply, the Q4 domestic environment shall generally be supportive of bonds. **We expect the 10s15s and 1020s segments to stay inverted**.



Source: MAS, Bloomberg, OCBC Research

IDR:

IndoGBs underperformed USTs over the past month. Short-end domestic yields corrected higher from being close to the policy 7D reverse repo rate, to nearer the 3-month reverse repo rate, in anticipation and later upon confirmation of a new monetary operation instrument (SRBI). Recent bond auction results have been mixed; the conventional bond sales received lukewarm demand, while above-target amount was awarded at the latest sukuk auction ahead of a heavy maturity. At the first SRBI auction on 15 September, the weighted average awarded rates were 6.299%, 6.391% and 6.405% for the 6M, 9M and 12M tenors, respectively. These rates were considered appealing compared to the 8M bond yield (FR77 which matures on 15 May 2024 bond) at 6.0%/6.2%. IDR24.456trn of SRBI was awarded, against incoming bid amount of IDR29.872trn. Investors might have lightened positions in other instruments in preparation for this first SRBI auction; we do not expect such relatively big magnitude of awarded amount to become the norm.

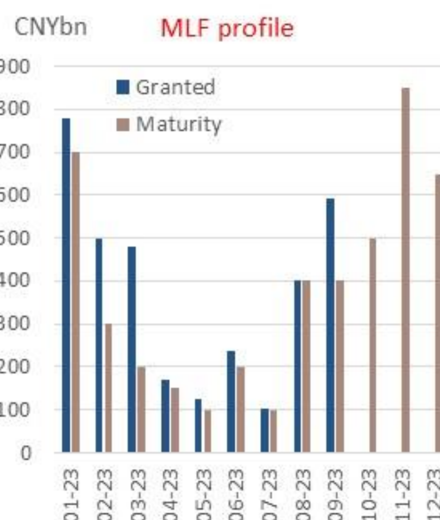


Source: Bloomberg, OCBC Research

The bond supply outlook is likely to stay sanguine, judging from the fiscal positions, but it also depends on if MoF choose to leave some fiscal surplus or to pre-fund for next year. IndoGBs saw foreign outflows of IDR8.9trn in August, and a further IDR8.8trn thus far this month (as of 14 September). Daily foreign flows have continued to fluctuate; a strong comeback of inflows into IndoGBs is not on the horizon yet, as IndoGB-UST yield differentials have largely stayed compressed. On balance, **between a likely sanguine supply outlook and a lack of substantial foreign inflows, we are neutral IndoGBs** at current levels.

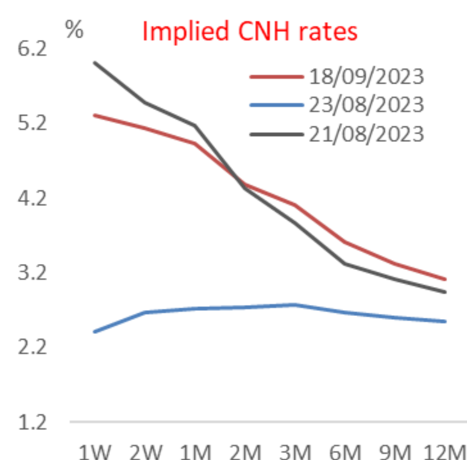
CNY:

Repo-IRS rebounded from the lows seen in late August. Daily fluctuations aside, we do not expect repo-IRS to break decisively below these previous low levels. The authorities have pushed out a slew of support measures over the past weeks; the more prominent ones have been the relaxation in mortgage rules/rates, and liquidity injections via an RRR cut and an outsized MLF operation which indirectly support fiscal spending. The RRR for FIs (except those which are already subject to the lowest 5% requirement) has been cut by 25bps, lowering the weighted average reserve requirement ratio to 7.4% from 7.6%. The RRR cut will release more than RMB500bn of liquidity – this, together with the net CNY191bn of liquidity injected via the 1Y MLF, helps buffer the liquidity tightening from LGB issuances as local governments target to issue up to this year's quota by the end of this month. MLF maturity is relatively heavy in the months ahead, adding up to RMB2trn in Q4.



Source: CEIC, OCBC Research

The 1Y MLF rate has been kept unchanged at 2.5%, suggesting that policy focus moves away from the price of money to more direct support via fiscal spending and liquidity injection. The 20bp cut in the rate on the 14-day reverse repo is simply a catch-up with the earlier rate cuts (10bps and 10bps) on the 7-day reverse repos. Room for further interest rate cuts appear limited. The improvement in August industrial production and retail sales is encouraging. Recent economic data point to some stabilization in economic activities, which **shall set a floor to CNY interest rates**. For a meaningful turnaround in CNY-USD rates differentials, however, easing in USD rates will be required.



Source: Bloomberg, OCBC Research

In offshore, we continue to **caution against sporadic tightening in CNH liquidity**, especially if the upward pressure on spot USD/CNH stays. RMB15bn of offshore PBoC bills are to be tendered on 19 September, more than the maturing amount of RMB5bn, thereby net withdrawing CNH liquidity. This follows the outsized offerings in August (also at RMB10bn net). **Back-end points/rates shall be better anchored**: 1/ back-end rates shall be less sensitive to the liquidity conditions while it is not desirable to squeeze the back-end as that would deter away genuine flows which go into RMB assets; and 2/ the off-onshore spread in the 12M forward point, at around 900bps,

is wider than what could be implied by the full impact of the 20% FX risk reserve requirement on the onshore curve, which may attract flows taking advantage of the spreads.

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