GLOBAL MARKETS RESEARCH

Daily Market Outlook

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Steepening continued; ECB rhetoric in focus

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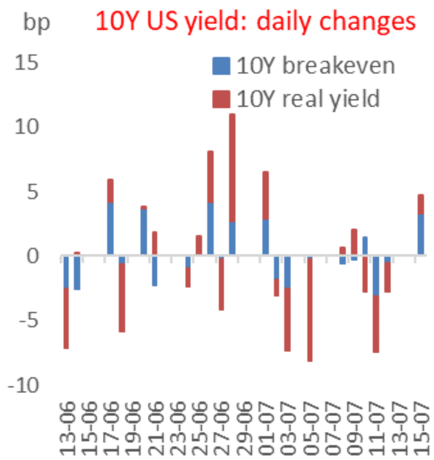
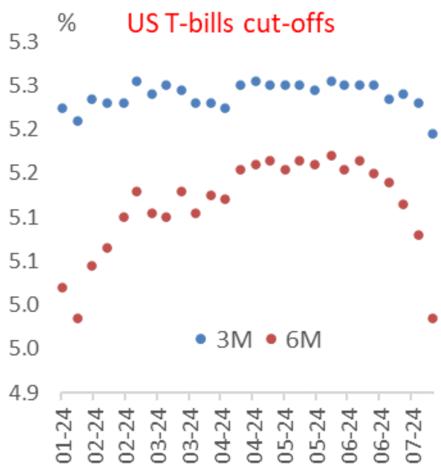
Global Markets Research and Strategy

- **USD rates**. The UST curve bearish steepened overnight, as investors added further to rate cuts expectations while long-term inflation expectation edged up. The 10Y term premium as measured by NY Fed's ACM model was a tad lower, not suggesting heightened worry over fiscal position. Overnight, the respective demand for 3M T-bills and 6M T-bills reflected heavier rate cut bets. The 3M cut-off was lower at 5.195% versus 5.230% prior, while the 6M cut-off fell by more to 4.985% from 5.080% prior. These resulted in a spread between 3M and 6M rates of -21bps versus -15bps at last week's auctions. Fed funds futures pricing turned slightly more dovish, with more than a 100% chance being priced for a 25bp cut by the September FOMC meeting, and a total of 68bps of cuts priced by year-end. Market rate cut expectation was reinforced by the latest comments from Powell, who said data in the second quarter has added somewhat to confidence that inflation is moving towards the 2% target; "now that inflation has come down and the labor market has indeed cooled off, we're going to be looking at both mandates". While we do not assume a Trump victory would lead to materially higher inflation or materially wider fiscal deficits, market may choose to position on such expectations in the interim; this, coupled with increasing conviction of the start of the easing cycle, shall underline our curve steepening view.

- **EUR rates and EURUSD**. Bunds mildly outperformed Gilts and USTs overnight, while EURUSD traded slightly lower following a modestly higher US dollar. The ECB is widely expected to stay put on rates this week, but investors look for hints of a September cut which is around 80% priced by swaps, although Lagarde is likely to remain non-committal. Bunds might also have continued to benefit from safe haven flows with unsettled fiscal issues in France, while France's state auditor earlier described the divergence of the budget deficit from other EU countries as "unacceptable"; note OAT-Bund yield spreads did not come in further in recent days. EUR OIS pricing of 44bps of rate cuts by year-end looks roughly fair compared to our base-case of 50bps of rate cuts between now and year-end. Technical wise for EURUSD, we continue to expect selling pressure at the 1.09 resistance level in the near term, before a more entrenched softening move in the Dollar itself. Looking further ahead, our view remains that a softer



Source: Bloomberg, OCBC Research

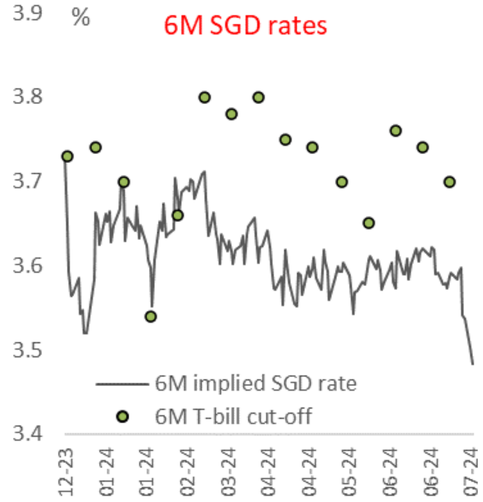


Source: CEIC, OCBC Research

dollar alongside expected growth pick-up in the Eurozone shall provide support to the EUR on a multi-month horizon.

- **SGD rates**. SGD OIS underperformed USD OIS in the latest leg of downward move, in line with historical pattern. Our medium-term view remains that SGD rates will likely lag USD rates in a downward move. That said, such underperformance may be mild only, especially if MAS keeps current S$NEER setting with a positive slope. Today brings the auctions of 4W and 12W MAS bills. The 1M and 3M implied SGD rates were last trading at 5bps and 7bps lower than the levels around the time of the previous auctions. We expect MAS bills cut-offs to come in the range of 3.80-3.85%. As for Thursday's 6M T-bills auction, the offer amount is SGD6.8bn which is a tad higher than those at the previous two auctions. 6M implied SGD rates has dropped by a cumulative 10bps since the last T-bills auction. T-bills cut-off may fall to the 3.60-3.65% area probably nearer the 3.60% handle.

- **HKD rates**. Market has added to expectation for the benchmark 3M HIBOR to fall, especially on a six-month horizon. 6x9 FRA on 3M HIBOR was last at 4.20%, versus current 3M HIBOR at 4.71% and our year-end expectation of 4.50%. The pricing may look overly dovish, as we expect short-end HKD rates to fall less than USD rates do. First, falls in USD rates are driven by expected monetary easing in the US itself; despite the peg, HKD-USD rates differentials do fluctuate. Second, HKD rates lagged USD rates mildly during the tightening cycle. We do however acknowledge there is downside risk to our short-end HKD rates expectations, which have been partly premised on expected inflows into HKD assets.



Source: MAS, Bloomberg, OCBC Research

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