Daily Market Outlook

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ECB policy decision; Japan CPI

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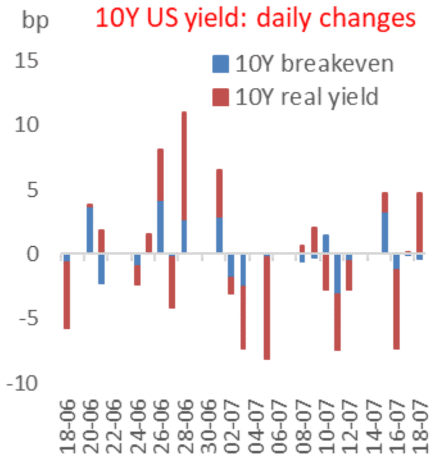
- **USD rates**. UST yields edged higher overnight, as rate cut expectations stabilised after a period of rapid adjustment, fitting into our near-term range trading view. The 10Y UST yield stayed within expected range of 4.10-4.30%; further downside to real yield would require additional economic data showing softness in the US economy. Overnight, initial jobless claims and continuing claims came in a tad higher than expected; yields did edge lower as initial reactions before rebounding. Ahead of July FOMC meeting, data releases include June existing home sales, new home sales, advance Q2 GDP, June personal income/spending, core PCE price index etc. The important July payroll and labour market report are however only released on 2 August. Overall, there may not be heavy-weight data that can move the needle for the near-term Fed funds rate outlook. On liquidity, usage at the Fed's overnight reverse repo has retraced from the recent peak at the start of the month, by USD265bn to USD399bn on Thursday, as the market entered Q3 facing net bills issuances. Next week, net bills settlement is planned at USD41bn, while there is a relatively heavy net coupon bond settlement of USD76.4bn on 31 July.



Source: Bloomberg, OCBC Research

- **EUR rates**. ECB kept policy rates unchanged as widely expected; the decision was unanimous. Balance sheet adjustment via APP and PEPP stays with plan, averaging EUR32.6bn per month in 2H-2024 which is similar to the EUR30.6bn in the first half; with balance sheet run-off via expiring lending having mostly run its course, overall QT is at a slower pace in H2 and well manageable. When asked about potential policy rate decision at the September meeting, Lagarde stayed non-committal and said the decision "is wide open". Our base-case remains for additional 50bps of rate cuts before year-end. Still elevated wage growth is a risk to our base-case, but ECB's assessment has it that profits helped to "offset the inflationary effects of higher unit labour costs", and that due to the way in which employment relationships are organised, wage is playing catch-up and "the highest numbers that you have are in '24". If the ECB is confident enough in their view that wage growth will return to levels that are "perfectly compatible with [their] target of 2% in the course of '25", another two rate cuts this year shall be on the cards in our view. EUR OIS pricing was little changed, seeing 44bps of rate cuts by year-end.

- **JPY rates.** Short-end JGB yields have been playing some catch-up of late in terms of updrift, although JPY OIS pricing of rate hikes remain pretty much unchanged. This morning, June CPI came in a tad lower than consensus; nevertheless, core CPI and core core CPI inflation did edge up, to 2.6%yoy and 2.2%yoy respectively, and stayed above the 2% mark. The macro backdrop is constructive for BoJ to go ahead with further monetary policy tightening in terms of both the policy rate and its balance sheet. We expect a 10bp hike in the BoJ target rate at the July MPC meeting. Meanwhile, to achieve "a sizeable reduction in the purchase amount" of JGBs, we expect the BoJ to tweak its monthly purchase guidance of JPY6trn to around JPY4trn. There are some JPY15-19trn of JGBs held by the BoJ maturing in each quarter. A monthly purchase pace of JPY4trn would translate into QT of around JPY22trn on a one-year horizon counting from this quarter, which still represents a slow pace of balance sheet run-off. The next support for the 10Y JGB remains at 1.15-1.25% in terms of yield.

Source: Bloomberg, OCBC Research

- **CNY rates.** Market may hold renewed hope for near-term monetary policy support as the Third Plenum focus on achieving growth target and reviving domestic demand. Repo-IRS were little changed however, before materialization of any policy action. We note CNY401bn of MLF matures in August, and another CNY591bn mature in September, which may provide an option for the PBoC to replace some of these liquidity with more permanent one via an RRR cut. Short-end CGBs appear to be supported for now, when the risk sentiment stays subdued. Northbound Stock Connect flows slowed in June versus previous months; flows picked up somewhat in July thus far but some of the recent days saw outflows. Next to watch is June FX sales and settlement dataset, to gauge inflow versus outflow pressure and also onshore entities' willingness to convert dollar proceeds into RMB.

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