Daily Market Outlook

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PBoC cut rates; CGB curve steepened

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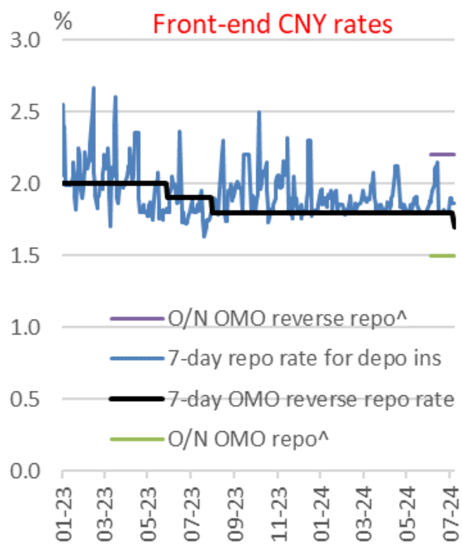
- **USD rates**. UST yields and DXY traded lower Asia open, after Biden announced on Sunday his withdrawal from the election bid. The marginal impact on the possibility of a Trump victory is too close to call at this stage, and we suspect FX and bond/rate reaction may be muted except there may be higher vols. Regardless, the Trump trade is not our thesis in the first place. Our base-case remains for 50bps of Fed funds rate cut by year-end; Fed funds futures price a total of 62bps of rate cuts this year. With 10Y breakeven at 2.3% and real yield at 1.9% which look roughly fair near-term, the 10Y yield is likely to stay in a range seen at 4.1-4.3% before the next catalyst including June PCE/core PCE on Friday. On liquidity, usage at the Fed's overnight reverse repo has retraced from the recent peak at the start of the month, by USD285bn to USD380bn on Friday, as the market entered Q3 facing additional net bills issuances. Net bills settlement is calculated at USD41bn this week, while there is a relatively heavy net coupon bond settlement of USD76.4bn on 31 July.

- **CNY rates**. PBoC cut the 7-day OMO reverse repo rate by 10bps to 1.7%, effectively moving the interest rate corridor down by the same magnitude to 1.5-2.2%. 1Y LPR and 5Y LPR have each been cut by 10bps as well. We wrote last Friday that "market may hold renewed hope for near-term monetary policy support as the Third Plenum focus on achieving growth target and reviving domestic demand". Next to watch will be a potential RRR cut. 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. CGBs rallied by 1-3bps this morning with the short-end to the belly outperforming. The 10Y dipped below the 2.25% mark. PBoC would like to support growth with liquidity injection while considering long-end yields as too low; PBoC may finally pull the triggers on bond selling under monetary operations. But monetary operation alone is unlikely to exert a lasting impact on the bond market, hence PBoC also tries to facilitate market selling of bonds. In this regard, PBoC announced this morning it would loosen the collateral requirement for MLF so that market participants can sell the bonds (PBoC specifically mentioned medium to long end bonds) they hold if need be. Given the subdued risk sentiment and worries over the near-term growth outlook, yields are unlikely to

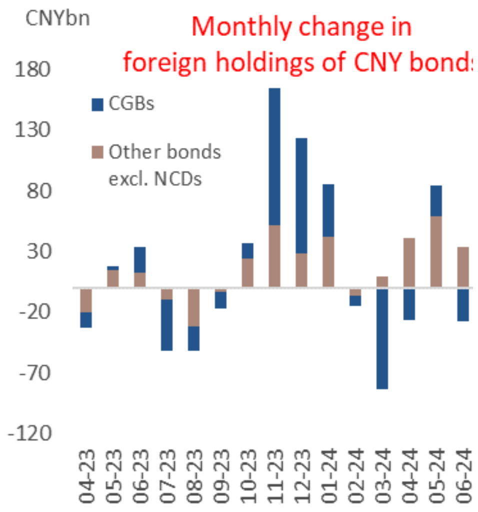


Source: Bloomberg, OCBC Research

^to be conducted depending on market conditions rebound strongly as yet. Overall, the policy backdrop shall add to our CGB curve steepening view.

- **CNY bond flows**. Separately, June bond flows data have been released. CGBs saw outflows of RMB28.1bn in the month; year-to-June outflows from CGBs amounted to RMB78.1bn. Some meaningful widening in the much-compressed CGB-UST yield differentials is needed before foreign investors stage a strong comeback, and this would in turn require UST yields to fall further and CNY rates to bottom out and rebound. While we have been looking for CNY rates to bottom out, a strong rebound in CNY rates is not in sight yet. Meanwhile, inflows into NCDs remained hefty, at RMB81.7bn in June after the RMB88.0bn in May. Asset swap into NCDs remained appealing, thanks to the low implied CNY rates. This window of opportunity has not closed yet, but investor positions are likely heavy which may slow additional flows going forward.

- **SGD rates**. Investors were seen reducing duration ahead of the reopening of 15Y SGS. The size of the 15 SGS (reopen) is to be announced on 23 July while the auction is held on 29 July. We expect the bond sales to attract some foreign demand on asset swap pick-up. Pick-up has generally narrowed over the past month, but remained decent at the long end, which was last at around SOFR+75bps (before bid/offer spread) at 15Y SGS, and at around SOFR+90bps at 20Y SGS. On the SGS curve itself, there is a mild kink at the 15Y compared to the 10Y and 20Y which may also be seen as providing some relative value. There may also be an increase in preference for duration if the lower rate-view becomes more entrenched.



Source: CEIC, OCBC Research

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