Interest Rates Monthly

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Central bank policy rate outlook

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- **USD rates**. A pause in rate cuts may come as early as January, versus from Q2 onwards as we previously anticipated. We have removed one 25bp cut from our forecast profile; we now expect one 25bp cut each in Q1, Q2 and Q3, adding up to 75bps of cuts in 2025. This profile represents a well slower pace of easing compared to the 100bps of back-to-back rate cuts that had been delivered. We have a downward bias to 2Y UST yield. First, market pricing of Fed funds rate appears overly hawkish to us. Second, 2Y breakeven at 2.5% suggests at least part of the potential inflation impact of tariffs is in the price.

- **JPY rates**. We expect further policy normalization in 2025, but we have made minor adjustments to our expected rate hike profile. The 15bp December rate hike that we had expected did not materialise but given the dissident vote was for a 25bp hike, we now see the quantum of each future hike at 25bps. We expect three 25bp hikes in 2025, which will then bring the BoJ Target Rate to 1.00% by end-2025.

- **GBP rates**. With three BoE member voting for a cut, the December policy rate decision was seen as a dovish hold. We maintain our expectation for one 25bp cut in each quarter of 2025 adding up to a total of 100bp cuts. However, further upside risk to inflation needs to be monitored. A quick reversal in long-end bond/swap move is not in sight yet.

- **SGD rates**. We expect mild downside to SGD rates over the coming months. Bond/swap spreads (OIS – yield) have corrected higher in line with our expectations. At current levels, there may still be some room for 20Y SGS outperformance against swaps although the move may not be as rapid.

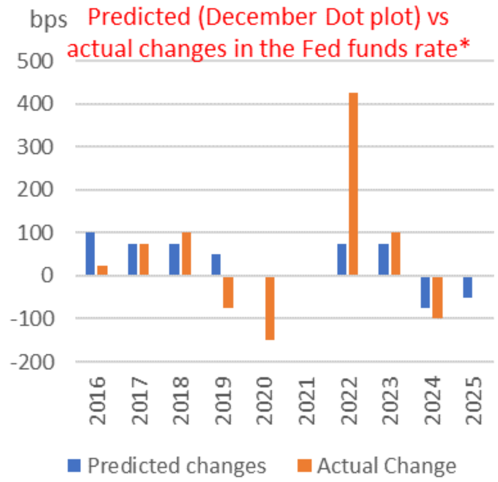
- **CNY rates**. Against a “moderately loose” monetary stance and a “more proactive” fiscal policy, we have a mild steepening bias to the CGB curve on a multi-month horizon. Front-end CNY rates are likely to stay well anchored with supportive liquidity and potential monetary easing.

USD:

Over the past month, market has further pared back 2025 rate cut expectation, with the latest trigger being the hawkish December FOMC outcome. Powell commented that the policy stance "is now significantly less restrictive. We therefore can be more cautious as we consider further adjustments to our policy rate". A pause in rate cuts may come as early as January, versus from Q2 onwards as we previously anticipated. We are removing one 25bp cut from our forecast profile; we **now expect one 25bp cut each in Q1, Q2 and Q3, adding up to 75bps of cuts in 2025.** Our base-case is more dovish than the 2025 median dot and current market pricing. First, our expected profile already represents a well slower pace of easing compared to the 100bps of back-to-back rate cuts that had been delivered. Second, after all, current interest rate level is probably still restrictive. For one, Powell opined the labour market is less tight than in 2019 – when the Fed funds rate peaked at 2.50%. We will review FOMC outlook again should inflation prove to be more persistent or rebound more forcefully than expected.

Source: Bloomberg, OCBC Research

December FOMC decision to cut the target range of the Fed funds rate by 25bps to 4.25-4.50% was not unanimous, with one member voting for a hold. Meanwhile, the o/n reverse repo rate has been cut by 30bps as we expected, to align with the lower bound of the Fed funds rate target range. 2025 PCE and core PCE inflation forecasts have been revised upward by 0.4ppt and 0.3ppt respectively, to 2.5% for both; 2025 GDP forecast has been revised mildly higher by 0.1ppt to 2.1%. The higher inflation forecasts help explain the more paced out rate cut cycle the updated dot-plot reflects. On the dot-plot, the median dots reflect 50bps of cuts in 2025, followed by 50bps of cuts in 2026, and a 25bp cut in 2027. Granted, these dots move, and past December median dots were not particularly accurate in anticipating the actual outcome.



Source: FOMC, OCBC Research

* predicted changes as reflected by the median dot on the December dot-plot in the previous year

Downward bias to 2Y UST yield. Short-end UST yields jumped alongside the higher market-priced trajectory of Fed funds rate. We have a downward bias to 2Y UST yield. First, market pricing of Fed funds rate – last at 38bps for 2025 - appears overly hawkish to us. Second, 2Y breakeven at 2.5% suggests at least part of the potential inflation impact of tariffs is in the price. At the longer end, month-to-date increase in 10Y UST yield was primarily driven by higher real yield, not reflecting heightened inflation worries – if it were due to higher breakeven it might have been better justified by the general worries over potential inflation impact of tariffs and the Fed's upward revision to inflation forecasts. The hawkish market repricing is probably done, and we do not expect the initial momentum to be much extended.

GBP:

BoE cut kept Bank Rate unchanged at 4.75% by a 6-3 vote; three members preferred to reduce the Bank Rate by 25bps. With three votes for a cut, the decision was seen as a dovish hold. Otherwise, the "outlook" paragraph in the MPC statement remained pretty much the same: "a gradual approach to removing monetary policy restrain remains appropriate. Monetary policy will need to continue to remain restrictive for sufficiently long". We maintain our expectation for one 25bp cut in each quarter of 2025 adding up to a total of 100bp cuts in 2025.

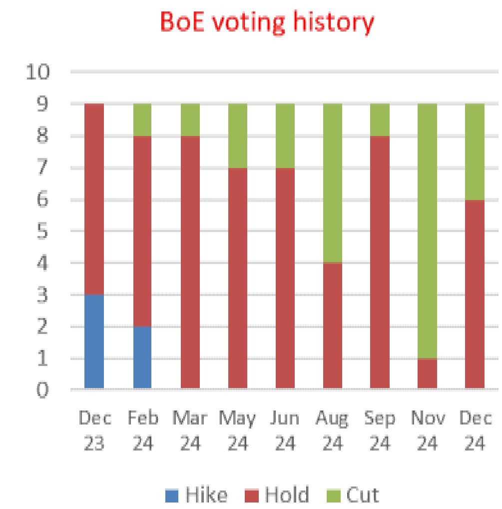
However, further upside risk to inflation needs to be monitored. October wage growth picked up more than expected in the Aug-Oct period to 5.2%YoY versus 4.9% (upwardly revised from 4.8%) prior. Wage growth re-accelerated before the expansionary Autumn budget is likely to have made an impact on inflation (official estimates put the impact on inflation at 0.5pp at its peak) and before wage growth is expected to be given a boost when the 2025 National Living Wage (NLW) uplift of 6.7% take effects from April 2025. But then payroll was on the weak side falling month-on-month and job vacancies fell; these echoed the weak employment component under PMIs released a day ago. Tax hikes and increase in employer's National Insurance Contributions (NIC) may be a potential constraint resulting in either resistance to wage growth or slowing hiring activities. On balance, CPI inflation may print for most of the months in 1H2025 in the range of 2.0-2.5%, which still support a gradual approach to removing policy restraint.

Long-end Gilt underperformance against swap has been further extended against the fiscal backdrop. While there may be some near-term consolidation, a quick reversal in long-end bond/swap move is not in sight yet.

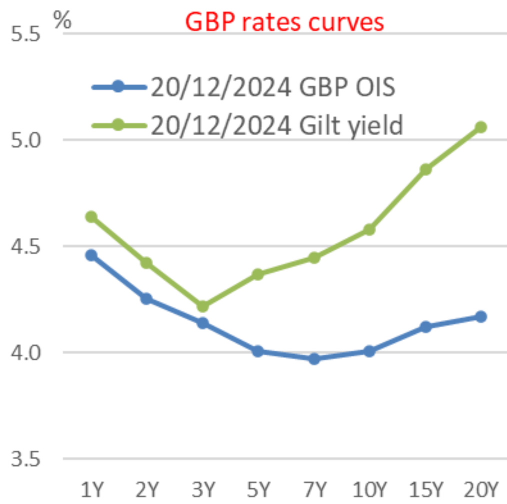
Interest rates forecasts	Q125	Q225	Q325	Q425
BoE Base Rate	4.50	4.25	4.00	3.75
GBP SONIA	4.45	4.20	3.95	3.70
3M GBP OIS SONIA	4.40	4.15	3.90	3.70

JPY:

BoJ kept the overnight call rate unchanged at 0.25% by an 8-1 vote, with Tamura voting for a 25bp hike. BoJ statement commented the "virtuous cycle from income to spending gradually intensifies"; and the "virtuous cycle between wages and prices continuing to intensify". These assessments could have well supported a rate hike decision. However, Ueda's comments during the press conference were seen as not hawkish enough with a lack of hint for a January hike - he



Source: BoE, OCBC Research



Source: Bloomberg, OCBC Research

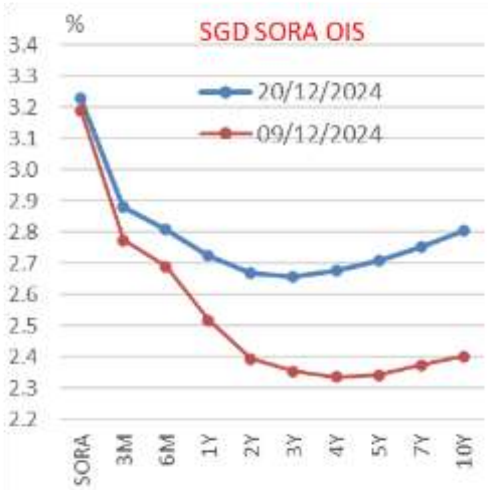
needed to see more information on wage growth and to watch momentum toward the next *shunto.* We continue to expect further policy normalization in 2025, as the prospect remains for inflation to stay sustainably around the 2% target, premised on a positive output gap and the virtuous cycle between wage and price continuing to play out as the labour market continues to tighten gradually.

But we have made minor adjustments to our expected rate hike profile. The 15bp December rate hike that we had expected did not materialise but given the dissident vote was for a 25bp hike, we see the quantum of each future hike at 25bp instead. We now expect three 25bp hikes in 2025, which will then bring the BoJ Target Rate to 1.00% by end-2025.

Interest rates forecasts	Q125	Q225	Q325	Q425
BoJ Policy Target Rate	0.50	0.75	1.00	1.00
JPY TONAR	0.48	0.73	0.98	0.98
3M JPY TONAR OIS	0.53	0.78	0.98	0.98

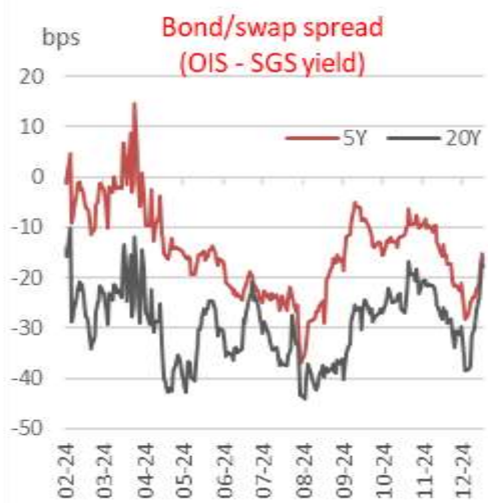
SGD:

In the recent leg of upward move in rates, SGD rates underperformed USD rates, resulting in bigger moves in SGD rates which was somewhat against historical pattern; SGD-USD OIS became less negative as a result. At the very front end, SORA the overnight rate itself has risen back to above 3% level, as liquidity got tighter going into year-end. Looking ahead, we **expect mild downside to SGD rates over the coming months**. First, we maintain a lower-USD-rates view especially for shorter tenors, but we expect SGD rates to underperform when rates are on a downtrend as per historical pattern and partly as spread normalisation. Second, the SGD OIS curve is inverted – albeit less so than a few weeks back - at the front part, having partly priced in expected downward moves in the floating rate, limiting further downside to these fixed SGD rates. Overall, SGD OIS-USD OIS spreads still appear overly negative to us.



Source: Bloomberg, OCBC Research

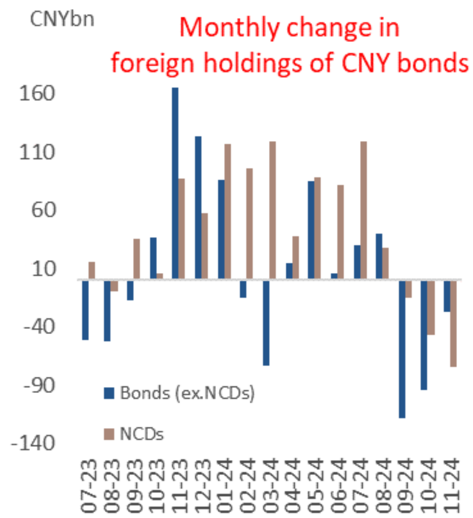
Bond/swap spreads (OIS – yield) have corrected higher in line with our expectations. At current levels, there may still be some room for 20Y SGS outperformance against swaps although the move may not be as rapid, as there is no 20Y SGS supply in 2025 and the next longer tenor SGS supply only comes in April 2025 with the reopening of 30Y Green Infra (after the new 10Y SGS in February). With the recent movement in bond/swap spreads while SGD basis have been relatively stable, asset swap pick-up has narrowed. Asset swap pick-up was last at around SOFR+67bps (before bid/offer spreads) at 20Y SGS, and at around SOFR+50bps at 10Y SGS.



Source: Bloomberg, OCBC Research

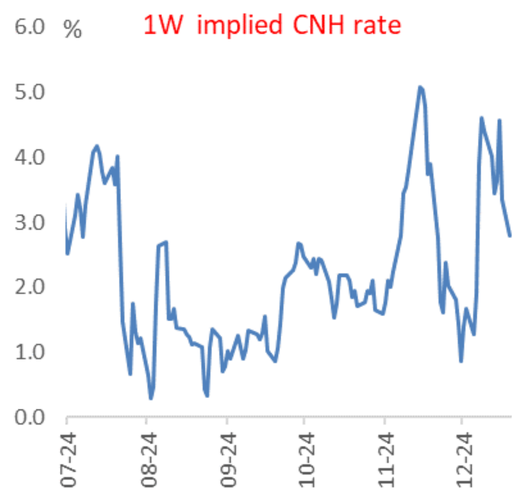
CNY:

CGB yields and repo-IRS have been falling steadily over the past month, amid a weak growth outlook and expectation for additional monetary easing. The monetary stance has been changed to "moderately loose". Even when the stance was "prudent" there was some monetary easing, and hence the explicit change in the wordings gives high hope for more monetary support to come including outright interest rate cuts. OCBC economists expect a total of 40bps of cuts in the 1Y LPR and 100bps of RRR cuts by end 2025. An outright interest rate cut may be a trigger for the 1Y repo-IRS to break below the 2020 low of 1.37%; the 1Y repo-IRS still appears relatively high compared to 2Y repo-IRS and to bond yields. Meanwhile, fiscal policy is "more proactive" instead of "proactive", reinforcing expectation for more supply to come. Against such monetary and fiscal policy backdrop, we have a **mild steepening bias to the CGB curve on a multi-month horizon**.



Source: CEIC, OCBC Research

Bond flows. Bond outflows eased in November to CNY27.7bn (excluding NCDs) from the outflows of CNY94.3bn in October; there were outflows of CNY20bn from CGBs and of CNY16bn from PFBs in November. NCD outflows however widened to CNY74.5bn despite some improvement in asset swap pick-up, as the pick-up was after all not as wide as those seen earlier in the year, while positioning and potential mark-to-market loss on the swap side were likely the constraints. Asset swap pick-up has improved further over recent days as implied CNY rates slid by more than NCD rates, but the flow prospect does not look particularly optimistic. Beyond the short end, UST-CGB yield differentials have widened further since the start of the month, which is not conducive to inflows either.



Source: Bloomberg, OCBC Research

In offshore, front-end implied CNH rates have been choppy. We opined front-end CNH liquidity remains as a tool to smooth spot movement. We stay cautious at the front-end, with **risk of sporadic spikes should spot move become disorderly, counteracted by dollar demand** running into year end. At the back end, the offshore-onshore spreads in FX points widened back, to more than the full impact of 20% FX reserve would imply and not all transactions are subject to such requirement. As such, LHS flows on the offshore DF curve at the back end cannot be ruled out.

Rates Forecast

USD Interest Rates	Q125	Q225	Q325	Q425
FFTR upper	4.25	4.00	3.75	3.75
SOFR	4.07	3.83	3.59	3.59
3M SOFR OIS	4.05	3.90	3.70	3.70
6M SOFR OIS	3.95	3.90	3.70	3.70
1Y SOFR OIS	3.90	3.85	3.75	3.75
2Y SOFR OIS	3.90	3.85	3.75	3.75
5Y SOFR OIS	3.85	3.90	3.80	3.80
10Y SOFR OIS	3.95	3.95	3.85	3.85
15Y SOFR OIS	4.00	4.00	3.90	3.90
20Y SOFR OIS	4.00	4.00	3.90	3.90
30Y SOFR OIS	4.00	4.05	3.95	3.95
SGD Interest Rates	**Q125**	**Q225**	**Q325**	**Q425**
SORA	2.90	2.78	2.65	2.50
3M compounded SORA	3.00	2.85	2.70	2.58
3M SGD OIS	2.70	2.60	2.55	2.50
6M SGD OIS	2.70	2.65	2.60	2.55
1Y SGD OIS	2.60	2.60	2.55	2.55
2Y SGD OIS	2.60	2.60	2.55	2.55
3Y SGD OIS	2.65	2.60	2.60	2.60
5Y SGD OIS	2.65	2.60	2.60	2.60
10Y SGD OIS	2.70	2.70	2.65	2.65
15Y SGD OIS	2.70	2.70	2.65	2.65
20Y SGD OIS	2.65	2.65	2.65	2.65
UST yields	**Q125**	**Q225**	**Q325**	**Q425**
2Y UST	4.00	3.90	3.85	3.85
5Y UST	4.10	4.05	4.00	4.00
10Y UST	4.35	4.30	4.25	4.25
30Y UST	4.55	4.45	4.45	4.45
SGS yields	**Q125**	**Q225**	**Q325**	**Q425**
2Y SGS	2.65	2.60	2.55	2.50
5Y SGS	2.70	2.65	2.60	2.55
10Y SGS	2.75	2.70	2.65	2.60
15Y SGS	2.75	2.75	2.70	2.65
20Y SGS	2.70	2.65	2.65	2.65
30Y SGS	2.70	2.70	2.70	2.70

Source: OCBC Research (Latest Forecast Update: 23rd December 2024)

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