Interest Rates Monthly

25 October 2024

Relative central bank dovishness; rising term premium

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- **Central Banks**. Market has repriced relative central bank dovishness, scaling back rate cuts expectation for the Fed but adding to rate cut expectations for the ECB and mildly for the BoE, primarily on the divergence of data when monetary decisions are said to be data-dependant. Our base-case remains for a 25bp Fed funds rate cut each at the November and December FOMC meeting (totalling 50bps before year-end). We also maintain our expectation for one 25bp cut by the BoE before year-end, at the November MPC meeting. We have added one 25bp cut for the ECB in our expected profile, at the December MPC meeting.

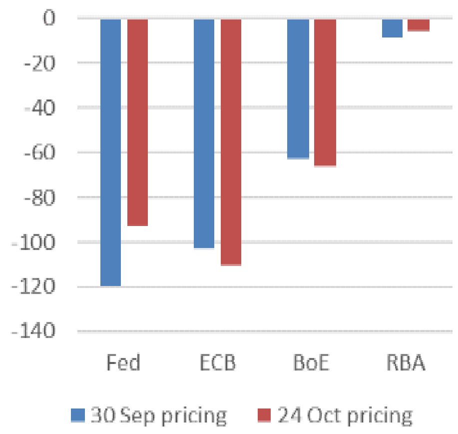
- **USD rates**. UST yields have been on a steady uptrend since mid-September, as market pared back aggressive rate cuts expectations upon prints of economic data showing resilience in the US economy. Increases in bond yields were extended probably because of the looming US elections and the accompanied concerns over the fiscal outlook. The rising term premium illustrates this point. In the interim to the US elections, curve steepening may remain as the popular trade, while steepening is also our medium-term view.

- **MYR rates.** How much the reduction in net borrowings in 2025 versus 2024 translates into lower net MGS+MGII issuances depending on MoF's strategy on bill issuances. Assuming minimal net bill issuances or a small bills paydown, we expect 2025 gross MGS+MGII supply in the range of MYR163-164bn.

- **SGD rates.** During the recent upward moves in rates, SGD rates outperformed USD rates in line with historical pattern. SGD-USD rates spreads became mildly more negative as a result, as we had expected a pause in the spread normalization. As the short-term momentum in USD rates has yet to turn decisively, we stay on the sidelines regarding this spread normalization trade.

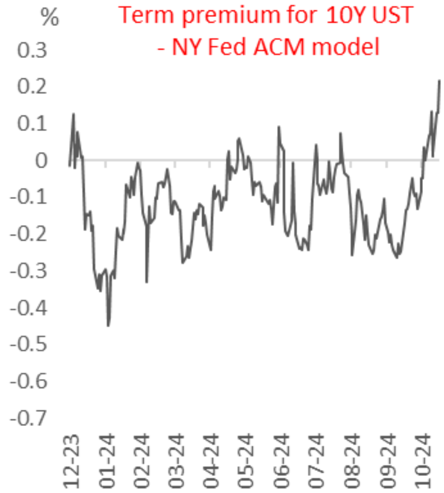
- **CNY rates**. The monetary and fiscal policy backdrop shall underline our steepening bias on the CGB curve. Another RRR cut before year end is likely, while fiscal stimulus shall put a floor to long end yields and potentially push these yields higher via a few channels: higher bond supply, better growth prospects, and asset re-allocation. We expect the 10Y CGB yield to trade in a range of 2.05-2.25%; this range reflects our upward bias to long end yields.

Pricings of rate cuts for 2024*



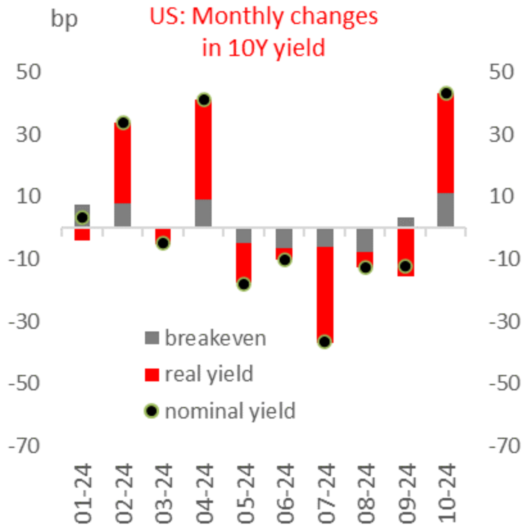
Source: Bloomberg, OCBC Research *include delivered cuts

USD:
UST yields have been on a steady uptrend since mid-September, as market pared back aggressive rate cuts expectations upon prints of economic data showing resilience in the US economy. Month-to-date, increase in the 10Y real yield explained around 75% of the uptick in 10Y UST yield, with breakeven explaining the rest. Recently, Fed funds futures pricings appeared to be relatively stable compared to bond yield movements. The increases in bond yields were extended probably because of the looming US elections and the accompanied concerns over the fiscal outlook. The term premium illustrates this point. The 10Y term premium as measured by NY Fed's ACM model returned to positive territory earlier this month and rose further to 0.23% on 23 October, the highest since Nov 2023. In the interim to the US elections, curve steepening may remain as the popular trade.



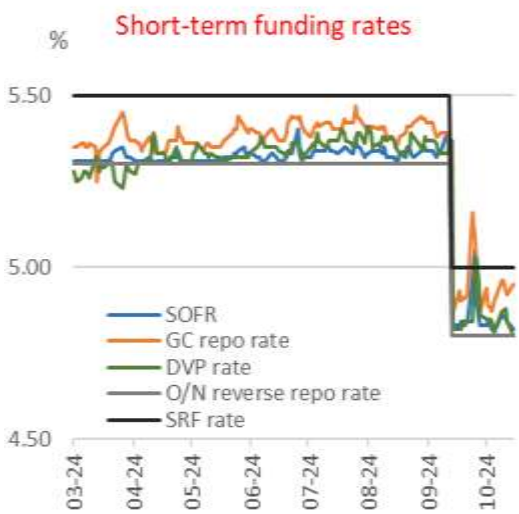
Source: Bloomberg, OCBC Research

Curve steepening is also our medium-term view. We have a downward bias to short-end yields as market has already adjusted higher Fed funds rate trajectory; as additional Fed funds rate cut materialise, it will be reflected in valuation at short-end bonds. At the longer end, weak data and subsiding fiscal worries are likely needed to push the 10Y real yield back to below 1.70%, while 10Y breakeven may fluctuate in a relatively wide range of 2.15-2.35%; these also give a wide range for the 10Y UST yield. Apart from the heavy data next week, US Treasury **Quarterly Refunding Documents** are released on 28 October. Net T-bills issuances are distorted by the debt ceiling deadline; according to the last quarterly review net bills issuances have been planned on the low side and they may still be some downward revisions. Bills issuance can catch up in Q1-2025 if a reinstatement of the debt ceiling is avoided. That all being said, market may look past this upcoming quarterly update, and contemplate any potential changes afterwards, depending on the election outcome.



Source: Bloomberg, OCBC Research *as of 24 Oct

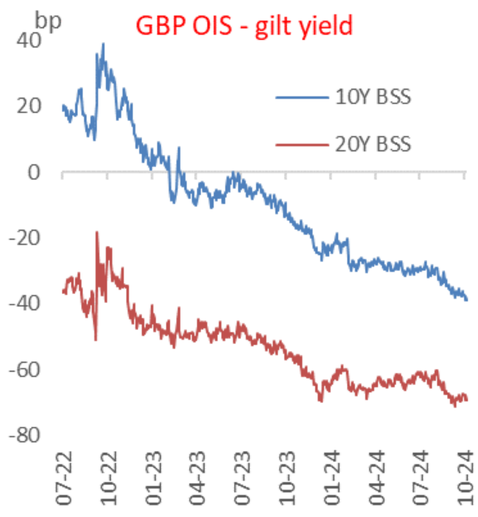
USD liquidity. The magnitude of the recent upticks in SOFR and some other short-term funding rates at quarter-end has caught market attention, although part of the jumps might be due to some specifics in the SOFR calculation. The NY Fed has recently launched the estimates of Reserve Demand Elasticity (RDE), after the set of reserve ampleness indicators launched in August. Thus far, the conclusion is "the elasticity of the federal funds rate to reserve changes is very small and statistically indistinguishable from zero" and this "suggests that reserves remain abundant". We believe USD liquidity will become one of key topics for the market at the turn of the year. Reduction in reverse repos have been absorbing the majority of the liquidity tightening from QT thus far, leaving bank reserves relatively more stable. It would then be natural to see lower bank reserves when usage of reverse repos falls to and stay stable at a low level. As bank reserves move from abundant to ample, front-end rates may become a bit more sensitive to changes in bank reserves.



Source: Bloomberg, OCBC Research

GBP:

GBP OIS added mildly to rate cuts expectation following the September CPI release but have since pared back partly such expectation as retail sales printed a tad firmer. September CPI inflation eased by more than expected to 1.67%YoY; CPIH (CPI including owner occupiers' housing costs) eased to 2.6%YoY versus 3.1%YoY prior. The main drag was price of transport, with larger negative contributions from airfares (-5.0%YoY) and motor fuels (-10.4%YoY). Owner occupiers' housing (OOH) costs inflation edged up to 7.2%YoY versus 7.1%YoY prior, which was the highest since March 1992, and this component helped explain the difference between CPI and CPIH. The ONS (Office for National Statistics) see CPIH as the most comprehensive measure of inflation. BoE's inflation target is on CPI, but they also look at CPIH. On balance, we stick to our call for a 25bp cut at the November MPC meeting and will review the potential for another cut in December.



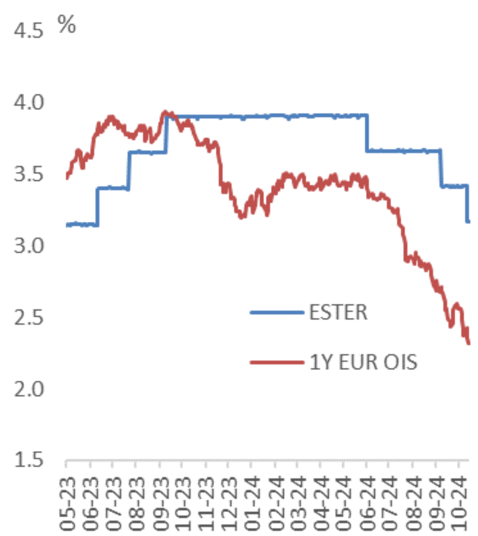
Source: Bloomberg, OCBC Research

Another focus is the Budget on 30 October. Expectation is for an upward revision in CGNCR (central government net cash requirement), upon potential for both higher taxes and higher expenditures. This expectation helped explain the gilt underperformance against Bunds, and long-end gilt underperformance on the curve. A looser fiscal policy may also limit the room/need for the BoE to cut rates, at the margin.

Interest rates forecasts	Q424	Q125	Q225	Q325	Q425
BoE Base Rate	4.75	4.50	4.25	4.00	3.75
GBP SONIA	4.70	4.45	4.20	3.95	3.70
3M GBP OIS SONIA	4.55	4.40	4.15	3.90	3.70

EUR:

ECB cut each of its three key interest rates by 25bps, as widely expected. The central bank said the decision is based on their "updated assessment of the inflation outlook, the dynamics of underlying inflation and the strength of monetary policy transmission". The meeting was not accompanied by the quarterly economic review, but from the statement there is a downward adjustment in the inflation outlook; the central bank now expect inflation to reach target "in the course of 2025" instead of "over the second half" of 2025. That said, as Lagarde pointed out, the MPC statement keeps the "magic language" that the central bank "will keep policy rates sufficiently restrictive for as long as necessary". Incoming official commentaries have been mixed, precisely showing the data-dependant nature of future monetary policy decisions.



Source: Bloomberg, OCBC Research

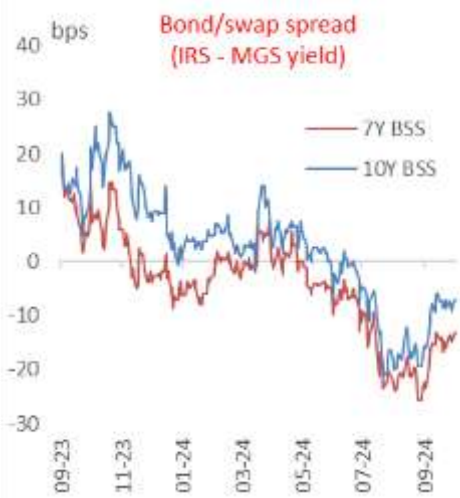
The final reading shows Euro Area HICP inflation eased to 1.7%YoY in September versus an upwardly revised 2.2%YoY in

August. The main drag to YoY inflation in September was transport which scrapped 0.3 percentage point from headline. By broader categories, goods price inflation was virtually flat (-0.02% YoY) while services inflation eased to 3.9%YoY. On balance, we now expect another 25bp cut at the December MPC meeting; we keep our expectation for 75bps of cuts in 2025. EUR OIS last priced a total of 35bps of cut at the December meeting, meaning market is split between a 25bp and a 50bp cut, which looks too dovish to us.

Interest rates forecasts	Q424	Q125	Q225	Q325	Q425
ECB Depo	3.00	2.75	2.50	2.25	2.25
ESTER	2.90	2.65	2.40	2.15	2.15
3M EURIBOR	2.85	2.65	2.45	2.25	2.30

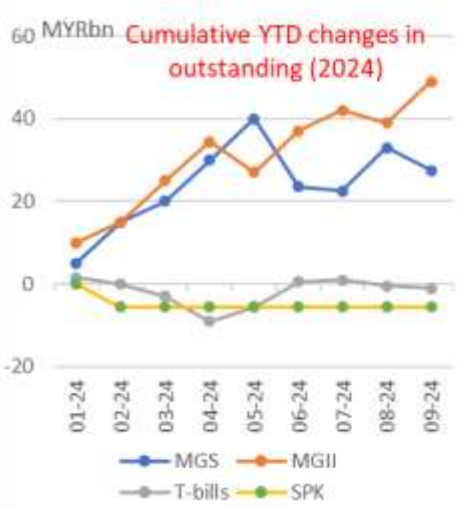
MYR:

MGS cheapened on the month, but outperformed USTs leading to a rewidening of the spreads between MGS yields and UST yields. In terms of yield differentials, short-end MGS are preferred on the curve, while across key Asia LCY markets, MGS also exhibit some relative value. Within the MYR market, bond/swap spreads (MYR IRS – MGS yield) have mostly risen in line with our expectations until the recent couple of days which saw some unwinding. Investors may have to be patient to reload the bond/swap trades, probably waiting out key risk event.



Source: Bloomberg, OCBC Research

2025 Budget. Budget deficit has been planned at MYR80.0bn for 2025 (3.8% to GDP), versus the revised estimate of MYR84.3bn for 2024 (4.3% to GDP), representing continued fiscal consolidation. The 2025 budget deficit was broadly in line with OCBC Economists' expectations.

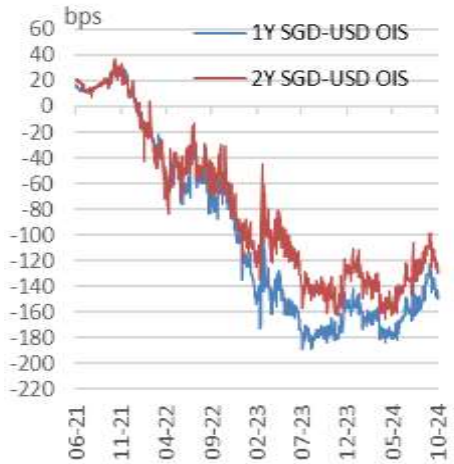


Source: CEIC, OCBC Research

2025 MGS+MGII supply. We expect gross MGS+MGII supply in 2025 at MYR163-164bn. MGS maturity is at MYR46.5bn in 2025, and MGII maturity is at MYR37bn, adding up to MYR83.5bn. Meanwhile, there is no more outstanding SPK. How much the reduction in net borrowings in 2025 versus 2024 translates into lower net MGS+MGII issuances depending on MoF's strategy on bill issuances. In 2023, there was net bills paydown of MYR11.5bn, while in the first nine months of this year there was a mild net bill paydown of MYR1bn. Assuming minimal net bill issuances or a small bills paydown as the MoF may look to reduce reliance on bills, we expect 2025 gross MGS+MGII supply in the range of MYR163-164bn. The supply outlook shall point to a constructive backdrop for the domestic bonds.

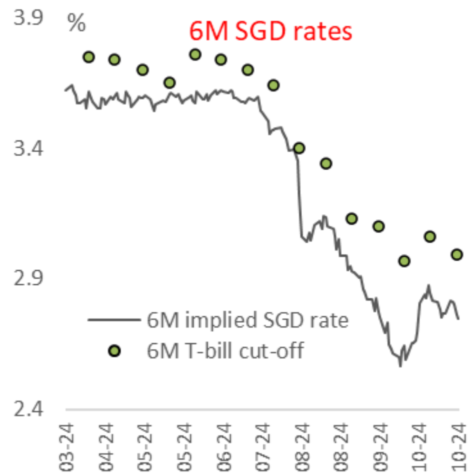
SGD:

During the recent upward moves in rates, SGD rates outperformed USD rates in line with historical pattern. SGD-USD rates spreads became mildly more negative as a result, as we had expected a pause in the spread normalization. As the short-term momentum in USD rates has yet to turn decisively, we stay on the sidelines regarding this spread normalization trade. Bond/swap spreads (OIS – SGS yield) went back down from the highs in late September with bonds underperforming swaps, possibly reflecting some unwinding of positions. After these adjustments, asset swap pick-up improved somewhat; pickup (before bid/offer) was last at around SOFR+48bps at 5Y SGS, around SOFR+59bps at 10Y SGS and SOFR+70bps at 15Y SGS.



Source: Bloomberg, OCBC Research

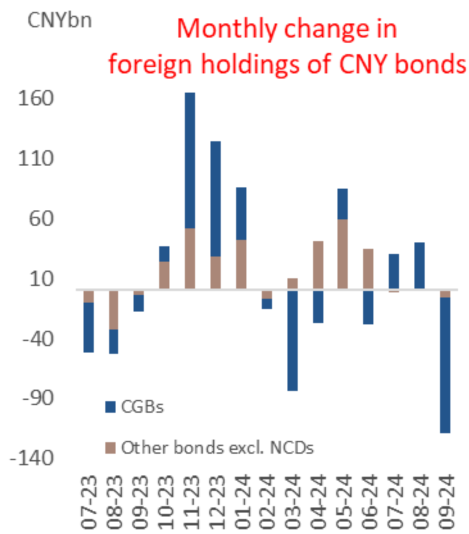
6M T-bills cut off at 2.99% at the 24 October auction in line with expectation. Earlier on 17 October, 1Y T-bills cut off at 2.71%, which was below expectations. The 67bp drop in the 1Y cut-off from the 3.38% at the previous auction on 25 July was mildly more than the drop in the 1Y implied SGD rate during that period. The outcome was against recent observations that the movements in the 6M T-bill cut-off have been tamer than the movements in market implied rate. The 1Y cut-off at 2.71% and the previous 6M cut-off at 3.06% meant investors expected the 6M rate to fall to below 2.35% six months later, which looked overly low to us. Using the latest 6M cut-off of 2.99%, the implied 6M6M rate is still low at 2.39%. The 1Y bill sales might have benefited from a lack of supply for the rest of the year. The downtrend in cut-offs shall not be automatically extrapolated.



Source: MAS, Bloomberg, OCBC Research

CNY:

The monetary and fiscal policy backdrop shall underline our steepening bias on the CGB curve. Another RRR cut before year end is highly likely, not only because the authorities have signaled such, but it also makes sense to release some long-term liquidity to buffer MLF maturity and/or additional bond supply. Fiscal stimulus shall put a floor to long end yields and potentially push these yields higher via a few channels: higher bond supply, better growth prospects, and asset re-allocation. We see the 10Y CGB yield to trade in a range of 2.05-2.25%; this range reflects our upward bias to long end yields where upside to the 30Y CGB yield is probably more.



Source: CEIC, OCBC Research

Bond flows. Onshore CNY bonds (excluding NCDs) saw huge outflows of CNY118.7bn in September mostly from CGBs, while NCDs saw CNY15.1bn of outflows. Foreign investment into front-end CNY fixed income products can be opportunistic in nature. Implied CNY rates were rising during September, narrowing the asset swap pick-up at NCDs which helped explain the NCD outflows. Further out the curve, rising US yields since mid-September and some asset reallocation into onshore equities might be the reasons for CGB outflows but still, the outflows were bigger than expected. The flow picture might have stayed subdued since then given the jumps in US yields in October thus far although implied CNY rates fluctuated.

FX swap points and implied CNY rates have been easing over recent days; 12M CNY implied rate was last at 1.1% versus 12M AAA NCD rate at 1.96% (which has risen from the lows in late September), rendering asset swaps pick-up appealing – again, these swap trades are opportunistic in nature and credit risk is not hedged. Offshore-onshore spread in FX points widened further as onshore points dropped more rapidly; 12M spread was last at 528pips, getting nearer the estimated 700pips as the full impact of 20% FX risk reserve would imply while not all entities are subject to this reserve. Flows coming in narrowing the spread from these levels cannot be ruled out.

Source: Bloomberg, OCBC Research

*estimation of full impact of 20% FX risk reserve

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