Interest Rates Monthly

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DM Central Bank outlook; implications on SGD rates

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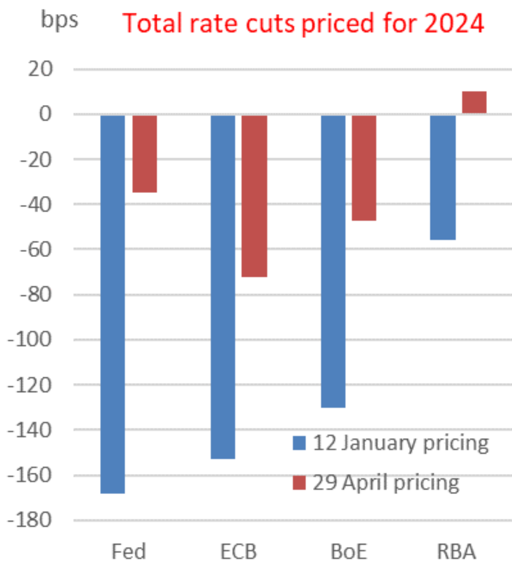
Since our last issue of *Interest Rates Monthly* on 15 March, market has further pared back rate cuts expectation across the major DM central banks that we monitor, more notably in the USD and AUD markets. We have earlier revised our Fed funds rate expectation, to 75bps of cuts this year, following our upward revisions to oil price forecasts and to 2024 US GDP forecast. We summarise in this report our latest views on the outlook for Fed, BoE, BoJ, ECB and RBA monetary policies.

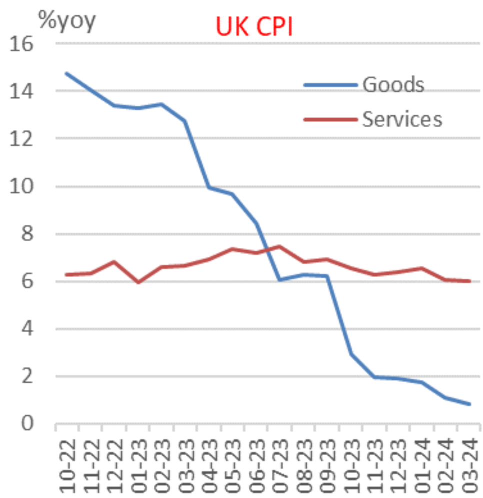
Fed. Our assessment is the broader disinflation trend remains, so does the Fed's easing agenda; but interim bumps in inflation mean the Fed is not going to cut rate just yet, and a delay in the timing of the first rate cut will reduce the room for rate cuts to be delivered between now and year-end. Energy inflation likely more than offsets the favourable base effect that we have emphasized, leaving headline inflation at levels that may be too high for the FOMC to gain enough confidence to start cutting rates at the June FOMC meeting. We expect the first Fed fund rate cut in July, and a total of 75bps of cuts this year.



Source: Bloomberg, OCBC Research

BoE. There have been pushbacks or caution against an early rate cut from various BoE officials in recent days. Our view has been for the first BoE policy rate cut to come only in August, given sticky services inflation. GBP OIS price the chance of a 25bp cut by the August MPC meeting at 89%, and a total of 46bps of cuts this year, in line with our base-case for 50bps of cuts. The pricing of cuts is evenly paced across monthly contracts, and as such we do not look for meaningful adjustment in these pricings. We expect 3M term SONIA to end the year at around 4.7%.

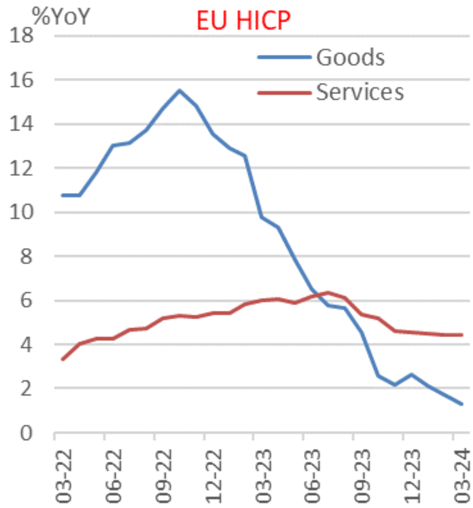
Interest rates forecasts	Q224	Q324	Q424	Q125
BoE Base Rate	5.25	5.00	4.75	4.50
GBP SONIA	5.20	4.95	4.70	4.45
3M GBP OIS SONIA	5.20	4.95	4.70	4.45



Source: CEIC, OCBC Research

BoJ. BoJ decided to keep the policy O/N Call Rate target range unchanged at 0.0-0.1% by a unanimous vote, in line with consensus and our expectation. The central bank will conduct bond purchases "in accordance with the decisions made at the March 2024 MPM". As we highlighted before, back in March, the BoJ already adjusted lower the upper bound of intended JGB purchase amounts. Passive QT may well start in June, in our view; a separate announcement of QT may not be seen as necessary. In terms of the policy O/N Call Rate target range, we expect additional 20bps of hikes this year to 0.2-0.3%.

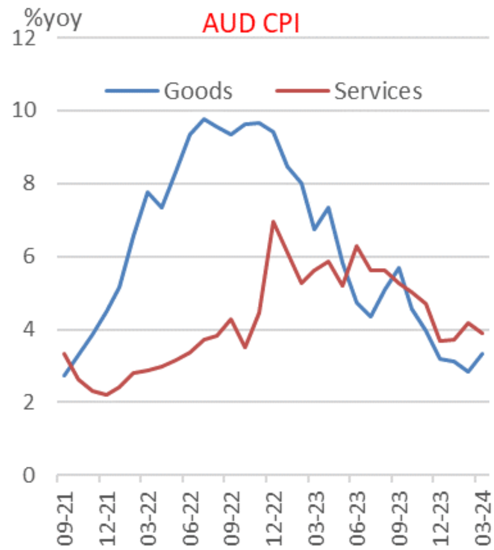
Interest rates forecasts	Q224	Q324	Q424	Q125
O/N Call Rate Target	0.10	0.20	0.30	0.30
TONAR	0.10	0.20	0.30	0.35
3M JPY TIBOR	0.25	0.35	0.45	0.45



Source: CEIC, OCBC Research

ECB. Our base-case remains for a total of 75bps of rate cuts this year, with the first cut likely coming in June as strongly hinted by various ECB officials including Lagarde. Q1 employment report to be out in mid-May shall be the last piece of evidence for the central bank to gain enough confidence to start cutting rates, when the growth outlook is tilted to the downside. That said, we are not looking for back-to-back policy rate cuts by the ECB.

Interest rates forecasts	Q224	Q324	Q424	Q125
ECB Deposit Rate	3.75	3.50	3.25	3.00
1M EURIBOR	3.60	3.35	3.15	2.90
3M EURIBOR	3.65	3.40	3.20	2.95



Source: CEIC, OCBC Research

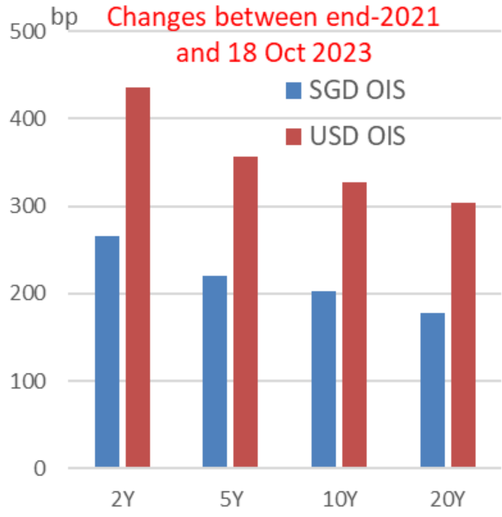
RBA. Our long-held view has been that the RBA would be among the last major central banks to start the easing cycle. Q1 CPI surprised to the upside, across headline, trimmed mean and weighted median. Sticky sequential inflation may further delay the timing of the first rate cut, which will then limit the room for the total magnitude of cuts to be delivered before year-end. We now expect one 25bp cut in the OCR this year, instead of two cuts. Given our flat profile of the OCR over the coming months, we expect the 1M and 3M BBSW to stay fairly stable at 4.30-4.40% before Q4.

Interest rates forecasts	Q224	Q324	Q424	Q125
RBA OCR	4.35	4.35	4.10	4.10
1M BBSW	4.30	4.30	4.10	4.10
3M BBSW	4.40	4.40	4.20	4.20

Note: for a full set of USD rates forecasts, please refer to the publication "USD rates and SGD rates forecasts update" dated 15 April.

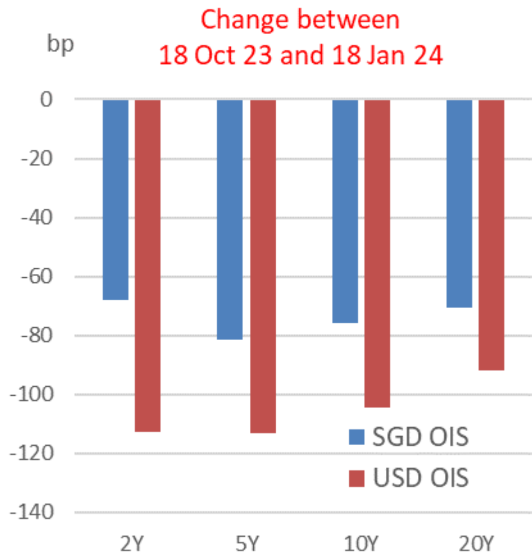
SGD:

SGD rates outperformed USD rates in the latest leg of upward movement in interest rates, resulting in yet more negative **SGD-USD OIS spreads**. This relative performance is in line with historical pattern and as we last wrote, *in either a rising or a falling rates environment, SGD rates are likely to stay relatively more stable than USD rates*. The pass-through from changes in USD rates onto SGD rates have not been 100%. During the upward move in rates in 2022 and through most of 2023 (up till mid-October when the 2Y USD OIS peaked), the pass-through from higher USD SOFR OIS onto SGD SORA OIS ranged 58%-62%, meaning SGD OIS did not rise as much as USD OIS did.



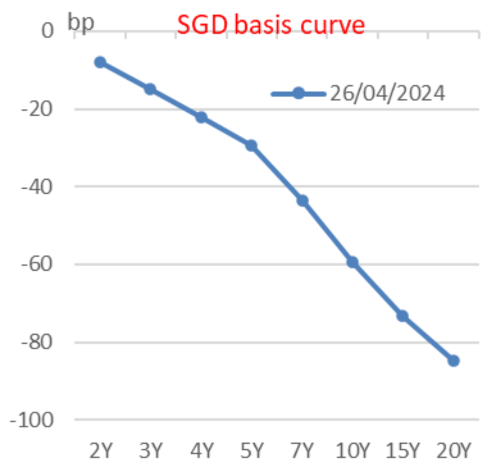
Source: Bloomberg, OCBC Research

This outperformance in SGD rates was attributable to a combination of factors. On the supply side, SGS supply outlook is always neutral to supportive, as there is minimum reliance on the proceeds to fund fiscal spending or projects. On monetary policy, the respective policies in the US and Singapore, if they are in the same cycle, exert opposite forces to their respective interest rates. When MAS tightens via an increase in the slope of its S$NEER policy band, for example, the more positive slope *per se* may exert a downward pressure on front-end SGD rates via the FX swap dynamics, other things being equal. Similarly, in the downward move in rates during mid-Oct 2023 to mid-Jan 2024, SGD rates lagged the move in USD rates, i.e. SGD rates underperformed USD rates, primarily reflecting the more stable nature of SGD rates and also as a partial normalization of SGD-USD rates spreads.



Source: Bloomberg, OCBC Research

Looking ahead, before USD rates embark on a more sustained downtrend, and with the S$NEER slope staying positive, SGD-USD OIS spreads are likely to stay deeply negative. Our medium-term view remains for short-end SGD rates to underperform USD rates in a falling rates environment, thereby partially normalising rates differentials – this move may only gain momentum later in the year when the Fed starts its easing cycle, and even then, SGD rates underperformance may be mild especially if MAS maintains policy setting. On balance, we expect SGD rates to grind lower in a gradual manner over the course of the year.

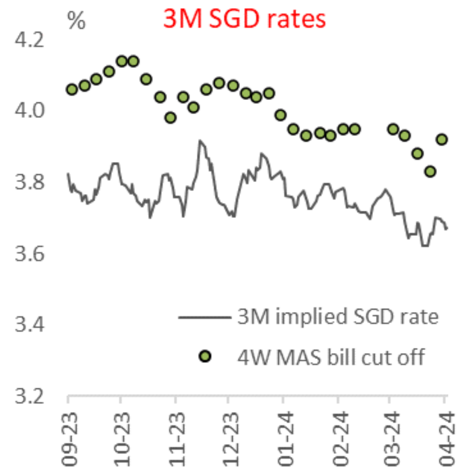


Source: Bloomberg, OCBC Research

Likewise, SGS have also tended to trade in a more stable manner than USTs. Longer tenor SGS are likely to be supported by asset swap flows and probably some residue bond/swap flows. **Asset swap pick-up** for USD funded investors becomes more appealing as we move further out the curve, as both the SGD basis and the SGD OIS curves are inverted. Pick-up was last at SOFR+70bps for 10Y SGS and SOFR+110bps for 20Y SGS (before accounting for bid/offer spreads). Domestically, the negative **bond/swap spread** (OIS minus bond yields) may also support some bond buying. The 10Y bond/swap spread, for example, was last at -19bps, the lowest this year. It was roughly around multi-year historical levels with reference to bond/IRS spread adjusted by a spread – we use a 30bp spread after considering MMR adjustment spread and historical SOR-SORA basis levels, but at current rate and yield levels, the bond/swap spread could have been less negative. On the **SGS curve** itself, 2Y SGS exhibits some relative value – its yield represents the highest point on the curve, and the tenor can better withstand the near-term risk of higher rates.

On bills side, recent **MAS bills and T-bills** auction results have come in pretty much in line with the prevailing market conditions. The latest 6M T-bills cut off at 3.74%, around 20bps higher than the 6M implied SGD rate, within the usual range. MAS bill cut-offs have also mostly come in at 20-25bps above implied SGD rates. The yield "premium" that MAS bills used to offer compared to T-bills vis-à-vis implied rates has become smaller, probably as the market has transitioned entirely to SOFR. When both LIBOR and SOFR were made reference to, MAS bills cut-offs were pulled slightly up by the higher LIBOR curve. Still, due to the shorter-tenors, MAS bills can at times offer higher relative yields when SGD liquidity tightens.

Note: for a full set of SGD rates forecasts, please refer to the publication "USD rates and SGD rates forecasts update" dated 15 April.



Source: MAS, Bloomberg, OCBC Research

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